TEAGUE P. PATERSON, SBN 226659
VISHTASP M. SOROUSHIAN, SBN 278895
**BEESON, TAYER & BODINE, APC**
483 Ninth Street, 2nd Floor
Oakland, CA 94607-4051
Telephone: (510) 625-9700
Facsimile: (510) 625-8275
Email: vsoroushian@beesontayer.com

Attorneys for Plaintiff
*AFSCME LOCAL 101*

**SUPERIOR COURT OF THE STATE OF CALIFORNIA**

**IN AND FOR THE COUNTY OF SANTA CLARA**

**AT SAN JOSE**

| | |
|---|---|
| SAN JOSE POLICE OFFICERS' ASSOCIATION, et al.<br><br>Plaintiff,<br><br>v.<br><br>CITY OF SAN JOSÉ, BOARD OF ADMINISTRATION FOR POLICE AND FIRE DEPARTMENT RETIREMENT PLAN OF CITY OF SAN JOSE, and DOES 1-10, inclusive,<br><br>Defendants. | Consolidated Case No. 1-12-CV-225926<br><br>[*Consolidated with Case Nos. 1-12-CV-225928, 1-12-CV-226570, 1-12-CV-226574, 1-12-CV-227864, and 1-12-CV-233660*]<br><br>**ASSIGNED FOR ALL PURPOSES TO: JUDGE PATRICIA LUCAS DEPARTMENT 2**<br><br>**PLAINTIFF/PETITIONER AFSCME LOCAL 101'S POST-TRIAL BRIEF**<br><br>Courtroom: 2<br>Judge: Hon. Patricia Lucas<br>Complaint Filed: July 5, 2012<br>Trial Date: July 22, 2013 |
| AND RELATED CROSS-COMPLAINT AND CONSOLIDATED ACTIONS | |

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Cases** **Page**

**Constitution and Statutes**

**Other Authority**

## I. INTRODUCTION

On July 26, 2013, the parties concluded their trial presentations, and were directed by the Court to file post-trail briefs in lieu of closing arguments. Plaintiff American Federation of State, County and Municipal Employees, Local 101 ("AFSCME" or "Union") submits this post-trial brief, which summarizes the points and authorities set forth in its pre-trial brief, offered in lieu of opening argument, and applies the facts and evidence adduced at trial. The law in this case greatly favors Petitioners' claims that Measure B is, in various respects, unconstitutional, because California public employees enjoy vested property rights in their retirement benefits upon commencing employment in the absence of a clear and unequivocal command from the agency indicating otherwise. At trial, Defendant City of San Jose ("City") failed to rebut this presumption. The City also failed to provide a constitutionally-tolerable justification of Measure B, and conceded that Measure B provides no "commensurate benefit" to the impairments it imposes (*See* Transcript of July 22-26 Trial ("Tr.") at 24:6-17.)

Rather, the City's trial presentation focused on the City's fiscal state and the extent of its pension and retiree health obligations (Exh. 6071; Tr. 1013:16-28; 1014:1-9) and the contention that City employees were granted "exorbitant" benefits. The evidence demonstrated however that Federated members received nothing more than what the state and other local agencies provided their workers. These defenses are insufficient as a matter of law to justify Measure B.

For these reasons and those discussed below, AFSCME is entitled to a favorable judgment on all claims in this case.

## II. BACKGROUND

AFSCME members earn and receive their retirement benefits under the "1975 Federated City Employees Retirement Plan" or the "Federated City Employees' Retirement Plan" ("Plan"). It is a defined benefit pension plan established by the City for its employees and administered by a retirement Board of Administration under the auspices of the San José Federated Employees' Retirement System ("System" or "SJFRS"). (*See* San José Municipal Code § 3.28.010 ("SJMC" or "Code").) Its provisions are enumerated in chapters 3.16, 3.20, 3.24, and 3.28 of the SJMC. (SJMC § 3.28.010(B)[1].) For decades, the AFSCME bargaining units' collective bargaining agreements ("MOU" or "MOA") with the City entitled AFSCME members to the retirement benefits set forth in the Code with language similar to the following: "Current retirement benefits will continue during the

[1] Sections 3.16, 3.20, 3.24, 3.28, and 3.44 of the San José Municipal Code are all found within Exhibits 602 and 5302. Measure B was introduced into evidence as Exhibits 700 and 5000. At times, this brief directly cites to provisions of Measure B and the Municipal Code, rather than to their corresponding exhibit numbers.

term of this Agreement, except as described herein, and shall be set forth in the Municipal Code." (Exhs. 300-320.)

The Plan is qualified under the Internal Revenue Code and established "pursuant to Sections 401(a) and 414(d) of the Internal Revenue Code, or such other provision of the Internal Revenue Code as applicable and applicable treasury regulations and other guidance of the internal revenue service." Because AFSCME's members are not enrolled in the Federal Social Security Old Age, Survivorship, Disability Insurance program ("Social Security") the Plan serves as an "alternative retirement system" pursuant to 26 U.S.C. section 3121(b)(7)(F) and 42 U.S.C. section 418(b)(4) and attendant regulations. (Tr. 105-06; 379; 498.)

The Board of Administration ("Board") governs the plan and is authorized to "fix and from time to time make such revisions or changes in the rates of contribution required of members and of the city as it may determine reasonably necessary to provide the benefits provided for by this retirement plan." (SJMC § 3.28.010(D), 3.28.200.)

## III. AFSCME's CHALLENGE TO MEASURE B

AFSCME challenges Measure B under the enumerated causes of action set forth in its First Amended Complaint ("FAC") as modified by the Court's Order Granting in Part and Denying in Part Defendant's Motion for Judgment on the Pleadings. Specifically:

Section 1506-A of Measure B requires employees who refuse to opt-into a "Voluntary Election Program" ("VEP") under Section 1507-A, must contribute up to sixteen percent of their pensionable pay to the System in order to pay up to 50% of the pension system's already-incurred unfunded accumulated actuarial liability ("UAL" or "UAAL"). Members who are unable or unwilling to pay such additional amounts must are placed into the VEP and are not required to contribute towards the System's incurred UAL, but rather see a drastic reduction in benefits, including a lower pension accrual rate, an unfavorable redefinition of "final compensation" for purposes of determining their pension annuity, a reduction in the cost of living adjustment ("COLA"), and a later eligibility date for service retirement.

Section 1509-A redefines the eligibility requirements for disability retirement in a manner that makes it more difficult to retire in the event of disability by changing eligibility rules contained in the Code. It also takes from the Board the authority to determine eligibility for disability retirement.

Section 1510-A gives the City authority to suspend COLA payments for up to five years upon declaring a "fiscal and service level emergency" If the City chooses to restore the COLA, it unfixes it for those who remain in the Tier 1 plan and, for those who opt-into the VEP, it subjects it to the conditions set forth in the VEP provision (Sec. 1507-A).

Section 1511-A eliminates the SRBR, a fund that provides an ad hos "13th check benefit."

Section 1512-A requires active employees to pay a minimum of fifty percent of the cost of all of the City's promised and vested retiree healthcare obligations, including both the normal cost and unfunded liabilities and "unvests" the retiree health benefits previously promised to members whil undermining the benefit through imposition of a new "low cost plan."

Section 1513-A imposes the on the Board to consider the City's economic interests equal those of the System's beneficiaries.

Section 1514-A provides that in the event that Section 1506-A(b) is found illegal, employees' pay will be reduced up to a maximum of 16% of pay.

Measure B provides no benefit to Federated members, and so AFSCME challenges the provisions as violations of the Constitution's:

- *Contracts Clause*: Cal. Const. Art. I sect. 9;
- *Takings Clause*: Cal. Const. Art. I sect. 19;
- *Due Process Clause*: Cal. Const. Art. I sect. 7;
- *Pension Protection Act*: Cal. Const. Art. XVI sect. 17; and
- *Right to Petition Courts*: Cal. Const. Art. I sects. 2 and 3.

AFSCME also asserts causes of action for common law promissory and equitable estoppel.

## IV. ARGUMENT

### A. Impairment of Contract

California's Contracts Clause prohibits the City from passing laws that impair contracts. Measure B violates the Contracts Clause with respect to its employees' promised pension and retiree health benefits.

#### 1. Pension Law and the California Contracts Clause

Public pension benefits serve "as an inducement to enter and continue in public employment" and provide agreed subsistence to retired public servants who have fulfilled their employment contracts." (*Carmon v. Alvord* (1982) 31 Cal.3d 318, 325 n.4; *Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 351; *Quintana v. Bd. of Administration* (1976) 54 Cal.App.3d 1018, 1021.) They may also serve as a replacement for Social Security.

"The pension provisions of a city charter are an indispensable part of the contract of employment between a city and its employees… which vests upon acceptance of employment." (*Abbott v. San Diego* (1958) 165 Cal.App.2d 511, 517 ("*Abbott II*").) Therefore, "upon acceptance of public employment [one] acquire[s] a vested right to a pension based on the system then in effect" and *"on terms substantially equivalent to those then offered by the employer ...."* (*United*

*Firefighters v. Los Angeles* (1989) 210 Cal.App.3d 1095, 1102 (emphasis in original) ("*LA Fire*"); *Pasadena Police Officers Assn. v. Pasadena* (1983) 147 Cal.App.3d 695, 703 ("*Pasadena Police*").) The Contracts Clause protects these retirement expectations. (*Allen v. Bd. of Administration* (1983) 34 Cal.3d 114, 120 ("*Bd. of Admin.*"); *Ass'n of Blue Collar Workers v. Wills* (1986) 187 Cal.App.3d 780 ("*Wills*") (right vested was "reasonable expectation" that city would meet statutory obligation to fund past-service liability).)

"This right arises before the happening of the contingency which makes the pension payable, and it cannot be constitutionally abolished by subsequent changes in the law." (*Wallace v. City of Fresno* (1954) 42 Cal.2d 180, 183 (citation omitted).) Upon entering the workforce, the public servant obtains a vested contractual right to benefit improvements conferred during employment. (*Betts v. Bd. of Admin.* (1978) 21 Cal.3d 859, 867.) As such, in the absence of *express* or "*clear* and *unequivocal*" language to the contrary, the public servant vests in the aforementioned expectations upon starting work. (*See Bd. of Admin., supra,* 34 Cal.3d at 124-25; *Pasadena Police, supra,* 147 Cal.App.3d at 704 n.3 (*citing Bellus, supra,* 69 Cal.2d at 348-352) (italics added); *see also Int'l Ass'n of Firefighters v. San Diego* (1983) 34 Cal.3d 292, 300-302 ("*SD Firefighters*").)

Although, "[a]n employee's vested contractual pension rights may be modified" such modifications must be "reasonable." (*Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131 ("*Allen*").) To be "reasonable," alterations to pension rights must bear a material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in a disadvantage to employees should be accompanied by comparable new advantages. (*Id.*) Importantly, "it is advantage or disadvantage to the particular employees whose own contractual pension rights, already earned, are involved which are the criteria by which modifications to pension plans must be measured…." (*Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, 449 ("*Abbott I*").)

Any "reasonable modification" defense posed by the City must clearly consider the detriment and commensurate advantages to the *individual employee*, and "benefits to other employees cannot offset detriments imposed upon those whose pension rights have accrued." (*Wisley v. City of San Diego* (1961) 188 Cal.App.2d 482, 486 (citing *Abbott I,* 50 Cal.2d at 453).) Rather, under *Allen*, a disadvantage to an employee must be ameliorated by a comparable advantage to that same employee.

It is recognized that "[t]he benefits conferred under a pension system by changes which are made from time to time prior to the adoption of an amendment imposing a detriment 'have no bearing upon the reasonableness' of the detriment so imposed; such benefits become a part of the vested rights of the employees when conferred." (*Abbott II, supra,* 165 Cal.App.2d 517, 518 (citing *Abbott I, supra,* 50 Cal.2d at 449).)

*Retired Employees Assn. of Orange County, Inc. v. County of Orange,* (2011) 52 Cal.4th 1171, 1186-87 ("*REAOC*"), does not change the law and is of limited value because it involved whether retirees had a vested right to participate in a health insurance pool that included active employees. (Id.) The Court held such a right could exist through an implied contractual there where no explicit right existed under local laws or resolutions. The court noted that collective bargaining agreements, or MOUs, could be a source of such law. (*Id*. at 1183.) Here, as explained below, the San Jose retiree health benefit is vested in the same manner pension benefits are vested; indeed it is a component of the Federated System, and is therefore provided under the Municipal Code and MOUs.

The City has cited federal authorities in the past to justify Measure B, yet federal authorities are not controlling and state courts have recognized the lesser protection afforded under federal law (*Walsh v. Bd. of Admin.* (1992) 4 Cal.App.4th 682, 697 ("On some occasions the United States Supreme Court has upheld modification of state pension plans under the contract clause. However, under California law there is a strong preference for construing governmental pension laws as creating contractual rights for the payment of benefits…").)

The City's has failed to demonstrate that Measure B provided its plan members with a commensurate benefit commensurate to the detriment imposed. The City admits this fact (*see* Tr. 24:6-17). In fact, the City averred that--for purposes of establishing a commensurate benefit--the appropriate comparison was not necessarily "between Measure B and what was there before; the relative benefit could be alternatives within Measure B." (Tr. 25:2-15.) The Court acknowledged, and the City admitted, that there are no authorities in support of such a theory. (Tr. 128:12-20.) Therefore, the only question before the Court is: does Measure B impair vested rights? As shown below, the answer is "Yes."

**2. Extent of Measure B's Impairment of Vested Rights**

a. Measure B's provisions obligating employees to pay for pension and retiree health unfunded liabilities constitute unconstitutional impairments of contract

Several of Measure B's provisions impose on employees the obligation to fund pension and retiree health system Unfunded Accrued Actuarial Liability ("UAAL"). These provisions include sections 1506-A (pension), 1512-A(a) (retiree health), and 1514-A (saving clause). Because retiree health is a component of the pension system, the analysis is equally applicable to both income-based and health-based retirement benefits.

"The pension provisions of a city charter or ordinance form an integral part of the employment contract." (*Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 852.) "Therefore, when

the ordinance establishing the pension plan can reasonably be construed to guarantee full payment to those entitled to its benefits regardless of the amount in the fund established by the pension plan, then [courts] are … required to construe the provisions liberally in favor of the applicant so as to carry out their beneficent policy." (*Bellus, supra,* 69 Cal.2d at 351 (citing case).) This is because courts "reject any theory that the provisions of the charter were designed to create an appearance of granting pensions while at the same time withholding the benefits by providing inadequate funds." (*England v. City of Long Beach* (1945) 27 Cal.2d 343, 348.) This is exactly what section 1506-A does: it withholds the benefits promised to employees unless they pay for the City's unfunded obligations with respect to those benefits by up to 16% of their salary. (It is likely the 16% excise will be reached (See Chart A (Indicating Federated System UALs exceed 280% of Citywide Payroll).)

On several occasions, our Supreme Court held that a municipality is required to cover its retirement systems' unfunded liabilities in the absence of clear language absolving it of such responsibility. (*Bellus, supra,* 69 Cal.2d at 336; *England, supra,* 27 Cal.2d at 343.) *Wills* succinctly summarized the *Bellus holding:*

> The Supreme Court… found that a charter city, possessed of plenary powers to adopt pension systems, was liable for pension payments which it had led its employees to reasonably expect. The *Bellus* court acknowledged that the insufficiency within the pension fund may have resulted from mere oversight. Nevertheless, the court found that the city bore a continuing obligation to contribute to the fund and to fulfill unfunded claims set up by the pension system.

(187 Cal.App.3d at 790.) Similarly, in *Pasadena Police* the court held "in the absence of a *clear and unequivocal* declaration in the pension provisions that benefits are payable only to the extent of available funds from specified contributions, the liability to pay promised pension benefits is a general obligation of the city." (147 Cal.App.3d at 704 n.3 (emphasis added).)

Importantly, the *Bellus* court also stated:

> [W]e must reject any argument 'that if a general obligation had been intended, the voters would have stated specifically that the city should levy a tax sufficient to cover all pension payments…. The rationale underlying the rule of construction [] that the City's liability for pension payments is not limited to the pension fund *unless the pension plan clearly specifies that limitation* - and the general rule the pension plans must be liberally construed to promote their beneficent purpose, rests on the same duty of fair dealing and obligation to protect the reasonable expectations of those whose reliance is induced that underlie the rules of construction in favor of the insured in insurance cases….

(*Bellus,* at 350 (emphasis added).) The court further noted, "[i]n this respect it is no different than any other employer or public service institution which induces reliance upon a contract which may reasonably be interpreted to afford that protection which has been impliedly promised." In the absence of a clear and unequivocal limitation on benefits resulting from underfunding, as stated in

*Bellus*, "we must conclude that the City [] bears a general obligation under the pension ordinance." (*Id*., at 352).

In *Bd. of Admin.*, a case in which the retirement rights of former legislators were at issue, the court found no impairment of contract because "[t]he essential and critical factor [wa]s that…respondents could [not] expect under the terms of their employment contract to obtain retirement allowances computed on the basis of the unique salary increase accomplished by the constitutional revision of 1966 *which expressly negated such expectations*." (34 Cal.3d at 124-25 (emphasis added); *See also England*, 27 Cal.2d at 344 (holding that the obligation to fund the benefits was a general obligation of the City because "there was no language in the charter which *expressly* limit[ed] pension payments to the money in the pension fund or to the particular items mentioned as source.").)

Merely because a pension system sets forth a method for funding a defined pension benefit, such provisions cannot be construed as a "qualification or limitation" on the pension benefits, rather it simple signals "orderly and customary means of administering city moneys." (*England, supra,* 27 Cal.2d 347; *Bellus, supra,* 69 Cal.2d at 350.)

Simply, cities that sponsor pension plans such as the Federated System may not pass debt onto employees by requiring them to pay increased pension contributions unless clearly authorized to do so by the charter or municipal code in effect at the time the employees commenced working. (*See Allen, supra,* 45 Cal.2d at 128; *England, supra,* 27 Cal.2d at 348; *Bellus, supra,* 69 Cal.2d at 352; *Bd. of Admin., supra,* 34 Cal.3d at 124-25.) Where a municipality is without explicit authority to raise the basis of the employees' contribution rates, the employees are only required to contribute at the rate in place during the time they were originally employed. (*See Wisley, supra,* 188 Cal.App.2d at 484-85 (affirming trial court's judgment that increases in contribution rate were unconstitutional and stating that "[t]he [trial] court concluded that the maximum amount that could legally be deducted from the employees' gross pay was that percentage which was in effect at the time each of the individual plaintiffs was originally employed").) This is because vested pension rights include not only the benefits payable at retirement but also the scope of a member's contribution obligation as defined under the terms of the contract in place at the time he/she began working.

In essence, section 1506-A must be rejected for the same reasons set forth in the seminal *Allen* decision. (*Allen*, *supra,* 45 Cal.2d at 128.) The court held that a change from a 2% to 10% rate was unlawful because it "constitute[d] a substantial increase in the cost of pension protection to the employee without any corresponding increase in the amount of the benefit payments he will be entitled to receive upon his retirement." (*Id.* at 131 ("[W]here the employee's contribution rate is a

fixed element of the pension system, the rate may not be increased unless the employee receives comparable new advantages for the increased contribution.").)

These "contribution rate cases" undermine the City's argument that its plenary power over wages extends to imposing additional pension fund contributions from wages. Such a result would allow the City to re-draft the pension for purposes of determining contributions on either a prospective or retroactive basis, contrary to established precedent. Importantly, Measure B only amends the charter and municipal code's pension provisions, and no others. It was neither designed, nor presented to the voters, as a change to the terms of compensation of City employees. Even the Measure's "Savings Clause" is found in the retirement provisions of the Charter. The effect of requiring additional contributions associated with unfunded liabilities is no different than retroactively imposing liability on employees for service they have already provided. If the City could not increase contribution rates prospectively under *Allen*, it certainly cannot do so retroactively.

The right City employees to pay only a portion of the normal cost of pension contributions is found throughout the municipal code. Only where increases were contemplated under the terms of the retirement system have courts permitted such increases, as in *SD Firefighters, supra,* 34 Cal.3d at 292. Indeed, in *SD Firefighters* actuarial funding of the pension system was subject to revision based on actuarial factors associated with normal cost, just as is the case with the Federated System. Thus, the court found that San Diego did not violate the Contracts Clause when it raised its employees' contribution rates *pursuant* to language within its municipal code and charter that clearly authorized it to do so upon the advice of an actuary." (*Id.* at 303 ("[T]he system does *explicitly* provide for both setting and *revising* of employee contribution rates upon the basis of the actuarial information and revisions thereto.") (emphasis in original).) As the chart attached hereto indicates, employee contribution rates have generally risen with actuarial valuations and recommendations adopted by the retirement board, but these revisions have *never* included any portion of accrued liabilities; they have always constituted only the prospective normal cost in accordance with the Code.

The San José Municipal Code is full of provisions requiring the *City* to cover the cost of its pension and other retirement benefit UALs. (See SJMC §§ 3.28.710, 3.28.880.) For example, SJMC sect. 3.28.710 states:

> The normal rate of contribution required of members shall be such that, based on interest and mortality tables and other relevant actuarial data, the total amount of normal contributions which will be required of members under the provisions of this chapter will be sufficient to pay, when due, three-elevenths of the amount of all pensions … which are and will become payable under this system on account or because of current service rendered on or after July 1, 1975; provided and excepting, however, that if and when, from time to time, the members' normal rate of contribution is hereafter amended or changed, *the new rate shall not include any*

> *amount designed to thereafter recover from members or return to members the difference between the amount of normal contributions theretofore actually required to be paid by members and any greater or lesser amount which*, because of amendments hereafter made to this system *or as a result of experience under this system*, said members should have theretofore been required to pay in order to make their normal contributions equal three-elevenths of the abovementioned pensions, allowances and other benefits which are or will become payable on account or because of current service rendered on or after July 1, 1975, and before the effective date of the new rate.

(Emphasis added.)

The City appears to contend that a dramatic change in the Federated plan's funded ratio necessitates the imposition of UAAL payments on employees. This argument makes little sense factually and legally. As indicated above, under law plan UAALs are a general obligation of the City. In addition, UAAL payments are associated with benefits earned by retired and deferred-vested employees as well as active employees. (Tr. 515 (Erickson); Tr. 270 (Lowman)). The City is therefore shifting its general obligation onto a small group of members, no different than if it required employees to pay a percentage of its cost for servicing various other obligations. This additional funding obligation cannot be a "reasonable modification" because it provides no commensurate advantage with respect to the particular employees involved, and (even if it did) the obligation to fund UAAL is not specific to the employee's share of the system's UAAL. Rather it is pegged to 50% of the City's entire UAAL obligation. As such, it is inherently *unreasonable*.

In short, the SJMC has provided for contributions of employees towards normal service costs, and no others.[2] It defines "current service" as any "service for the city on or after July 1, 1975.) (Exh. 5302, SJRJN000115 (section 3.28.030.08)), and provides for "Member's accumulated normal contributions" with respect to current service and prior service. (*Id*.) "Prior Service" means employment prior to the City's adoption of the plan in 1975. "Normal contributions" are defined as "contributions made by a member on account of current service at the normal rates of contribution fixed by the Board." (*Id.*, SJRNJ0000117 (section 3.28.030.20).)

Further, section 3.28.700 provides that member contribution rates are to be actuarially determined and made on a 3/8 ratio, and the Retirement Board is empowered to fix the contribution rate. (*Id.*, SJRJN000118-119). It should be noted that, if the plan were ever terminated, the Municipal code requires that all employees be paid their earned benefits. (*Id.*, SJRJN000117 (section 3.28.070(B)(3).)

[2] Unlike with its UAALs, the Board retained authority to adjust normal cost contributions for the City and its employees. Consistent with the Pension Protection Act ("PPA"), the Retirement System continually and appropriately revised its normal cost contributions with each valuation, and, indeed, these contributions have risen over the years (see Chart A, Attached hereto).

For more detail, Part 6 of the Federated Retirement provisions of the municipal code, commencing at 3.28.700, provide for a detailed description of "member contributions." (Exh. 5302, SJRJN000145, *et seq*.) However, the section makes clear that if the contribution rates are adjusted,

> the new rate shall not include any amount thereafter designed to recover from members or thereafter to recover from members or return to members the difference between the amount of normal contributions theretofore actually required to be paid by members and any greater or lesser amount which, because of amendments hereafter made to this system or as a result of experience under this system, said members should have theretofore been required to pay in order to make their normal contributions equal thee-elevenths of the abovementioned pensions.

(Exh. 5302, SJRJN0000145). Part 7 of Chapter 3.28 also defines "City Contributions" ((Ex. 5302 at SJRJN000150, *et seq*. (Code 3.28.850, *et seq*.), and notably, section 3.28.880 defines the City's obligation to pay for UAALs, or the "Current service deficiency rate" (Exh. 5302, SJRJN0000151). This City obligation is associated with contributions "resulting from amendments… or as a result of experience." (*Id*., SJRJN000151).

With respect to vesting, Section 3.28.1080 of the Code states that "[a] member shall be one hundred percent vested in his or her service retirement benefit under the applicable provisions of the retirement system." (Exh. 5302, SJRJN 000164). Although section 3.28.1080 provides that this provision should not be construed to limit "modification of benefits," the reservation also states "to the extent such modification is otherwise allowed under federal and state law." (Exh. 5302; SJRJN000164). Thus, the municipal code recognizes that the pension contract is to be construed in accordance with state law, and a vested member is entitled to receive the service and disability pension provided for upon reaching retirement.

The City has consistently recognized its obligation to pay 100% of all System UAALs (Exh. 445, AFSCME002647), as well as the fact that employee normal contributions are only 3/11ths of normal cost (See Exhs. 397-411 (plan valuation reports indicating normal cost contributions).) The City also recognized and conceded in retirement system handbooks that employees are not liable for UAAL contributions. (Exh. 328 (AFSCME001238) ("Contribution rates are changed from time to time, but these changes are not retroactive.")

Importantly, AFSCME's MOUs with the City - which are binding contracts that can give rise to vested rights - have stated for decades, "[E]xisting benefits within the scope of representation provided by ordinance or resolution of the City Council or provided in the San Jose municipal shall be continued without change during the term of this agreement." (Exh. 300; AFSCME 0435, *see also* Exhs. 300-320 (containing similar provisions)). These agreements each contained a "zipper" clause,

meaning that neither party could require the other to waive or amend any condition in the agreement. (*Id.*) Thus, because the MOUs were fully integrated agreements containing a "full understanding, modification and waiver" provisions, (Exh. 301, AFSCME001160; Exh. 303, at Art. 2), and were adopted by resolution of the City Council (*e.g.,* Exhs. 5461, 5469), indicates that imposition of additional payments associated with service during the periods covered by the MOUs is improper and contrary to the MOUS.

*b. The Municipal Code does not contain any clear waivers regarding UALs that would save Measure B's contributions provisions.*

There has been no waiver of the City's obligation to be fully responsible for the system's unfunded liabilities. At trial, the City mistakenly referred to "UALs" as "Prior Service" contributions, towards which employees might be required to contribute pursuant to the SJMC. Further the City contended that a provision adopted in 2010--SJMC section 3.28.755-- permits imposing UAAL contributions on members. As explained below, neither constitutes a basis for altering AFSCME members' pension rights with respect to pension funding.

*i. "Prior Service" Does Not Equate to UAAL.*

City Charter section 1505(c), which specifies that the normal cost contribution ratio "does not apply to any contributions required for or because of any prior service or prior service benefits" is unhelpful to the City because "prior service" is defined as "all city service rendered by a member prior to July 1, 1975." As such, "prior service" refers to service provided prior to the enactment of SJFRS, whereas "current service" refers to service rendered on or after that date. (Exh. 5203, SJRN000115, 117 (SJMC, §§ 3.28.030.08; 3.28.740, .755; .900, 2500).) Therefore, the City has no authority to require employees to fund UAALs for years of service since 1975.

Further, the City Charter never equated the term "prior service" with service performed under the previous federated system. Rather the Charter contains a specific definition of "service," defined as "all service for which an officer or employee is entitled to credit under the provisions of the retirement system" (Exh. 5216 (Section 1505(d)), and so is distinct from "Prior Service."

The retirement handbooks also confirm that "current service" means any service since July 1975, and "prior Service" is service prior to that date. (Exhs. 328 (AFSCME001228, 001230), 329 (AFSME003901).) Plan actuarial reports have also long-recognized this meaning, noting "The prior service rate (Code Section 3.28.740) is to pay for the 42% of the difference in costs between the current plan and the predecessor plan for service before July 1, 1975. Similar to the Normal Rate, the Prior Service Rate does *not* reflect the costs of past experience gains/(losses), changes in assumptions, and amendments affecting service before July 1, 1975." (Exh. 467 (AFSCME003644).)

Clearly the Plan's "Prior Service" provisions do not authorize Measure B's imposition of additional contributions associated UAALs.

*ii. 2010 Bargaining and SJMC section 3.28.755*

The City also sought to justify Measure B under section 3.28.755, which was adopted in order to authorize a one-time payment of contributions on the part of some bargaining units (but not AFSCME). For the reasons set forth in the *POA*'s and *Mukhar* Plaintiffs' post-trial briefs, section 3.28.755 does not authorize Measure B's funding provisions. With respect to AFSCME members, section 3.28.755 cannot be construed as an unmistakable waiver of the right to be free from the obligation to pay system UAAL, because a waiver of a constitutional right must be clear, unmistakable, intelligent, and voluntary. (*See In re Johnson* (1956) 62 Cal.2d 325, 335.)

The City never negotiated Section 3.28.755 with AFSCME. In fact, the City adopted section 3.28.755 during the pendency of AFSCME's contract, and AFSCME specifically rejected the City's request to bargain additional pension contributions. (Tr. 379:16-22; 743:9-25; 922:26-28; 923; 924:1-4.) That the City negotiated a one-time additional contribution with other municipal unions has no bearing on AFSCME's or its member's expectations with respect to pension benefits and funding. An agreement by a particular bargaining unit does not bind other bargaining units or retirees. (Tr. 931:13-21.) Therefore, section 3.28.755 cannot serve as a waiver of vested rights protected by the California Constitution, since a rejection of the City's request indicates no waiver could have taken place. Indeed, section 3.28.755 has never been applied to AFSCME members.

The meaning and effect of section 3.28.755 is at best ambiguous, as section 3.28.955 of the Code states that the City is entitled to an offset of its contributions related to "the additional employee retirement contributions that are made under section 3.28.755 against the retirement contributions the City would otherwise be required to make under this Part 7." (Exh. 5302 (SJRJN000153).) AFSCME members have never "made [any retirement contributions] under" section 3.28.755, and Measure B does not designate employee UAAL contributions as being "made under" section 3.28.755. When situated in the context of the specific 2010 bargaining (in which AFSCME did not participate), it is clear the "made under" provisions refers to a specific one-time contribution (as detailed in the POA's and Mukhar Plaintiff's post-trial briefs).

If the City's contentions were correct, the "made under" reference would be superfluous, as it could lead to the improbable result that the City may mandate employees pay all contributions to the System, entitling it to "an offset" so that it pays nothing. No such stark waiver of a constitutional right - which must be clear and unmistakable - is plausible under section 3.28.755.

*iii. Plan Underfunding is the Result of "Plan Experience" Under the Municipal Code*

The Plan's UAALs are the result of investment experience and, to a much lesser degree, plan amendments. Therefore the SJMC shields employees from paying the cost of these liabilities.

The City contends that, since the 1970's, the pension plans were well funded, and the current "spike" in unfunded liabilities establishes changed circumstances permitting imposition of new unanticipated employee funding requirements. This contention conflicts with the SJMC which, as described above, specifically insulates employees from the volatility occasioned by plan experience and plan amendments.

Mr. Lowman, an enrolled actuary, testified that, with respect to any pension plan, "there is volatility in large part because of investment returns being higher or lower" (Tr. 224), whereas normal cost is a "pretty stable number." (Tr.225). This volatility becomes more pronounced when spread across a smaller payroll, as it has in recent years. (Tr. 511.)[3] Mr. Doonan also testified that the City's payroll has diminished substantially over the years, to the tune of $83 million (Tr. 325) (which in fact *reduced* annual normal costs by $11million). Ms. Figone also agreed, testifying that the City had reduced its workforce by 2,000 employees, with 1,600 of these reductions occurring in 2009-10 period (Tr. 570). The City's 2012 Comprehensive Annual Financial Report ("CAFR") supports these conclusions noting, at page 104, that the change to the plan's UAAL (for that year) was due to decreases in the investment return assumption (e.g. reduction in discount rate), wage assumptions, and a decrease in the number of active members and payroll. (Exh. 397, p. 104.) The current funding deficiency is nearly solely attributable to these factors and investment or market experience. (Tr. 299 (Lowman); Tr.516 (Erickson).) In its statements to bondholders and potential bondholders, the City has assured them that the plan's unfunded ratio is due to market losses (Tr. 678).

The pension contribution rates of which the City primarily complains are a creature of the Great Recession and the demographic impact of excessive retirements. (Exh. 402 (noting funded ratio is due in part due to "many more retirements at earlier ages than expected" and resulting "significant retiree medical premiums increases" and "more retirees receiving medical benefits than expected" combined with "an unpredicted decrease in active member payroll).) The 2012 valuation report states: "When a fixed liability is financed over smaller than expected payroll, a higher percentage rate

[3] It is undisputed that the City has experienced significant and actuarially unanticipated retirements in recent years, starting in 2011, which coincided with layoffs and pay reductions, which would typically result in earlier-than-anticipated retirements (Tr.358). Ms. Erickson agreed that the ratio of employees to retirees and their beneficiaries was dire, and has a dramatic effect on contribution "rates" (Tr. 499), and testified that currently the ratio of active to retired members is 0.83 to one (Tr. 500), and the ratio does not include deferred-vested members (Tr. 501). As she explained, fewer employees are shouldering the burden of a greater number of retirees, which is exacerbates, and amplifies, the unfunded liabilities of the Plan. (Tr. 50; 516.)

of the unfunded UAAL results." (*Id*. at p.7).) In the 2012 plan valuation report, the actuaries stated, "The large increase in the contribution rate is mainly due to a decreasing Tier 1 payroll which causes the UAL rate to increase." (Exh. 416, p. AFSCME). Thus, while the spike in unfunded liabilities in 2008 and onward was the result of poor market experience, the continuing increase was the direct result of the impact of the City's austerity measures on payroll. Expressed as a percentage of a dwindling payroll, the obligations appear to be skyrocketing, but this says more about the size of the payroll, and less about the cost of benefits. (Tr. 307)

Although Ms. Erickson noted that from 1980 to 2007 the City's contribution rates to the pension plans for their "Annual Required Contribution" ("ARC"), which includes both normal costs and UALs, remained static (Tr. 511), the data tells a different story. As indicated on Chart A, attached hereto, the funded ratio of the Plan has gone up and down, as have contribution levels, over the years. But expressed as a percentage of payroll, the City's obligations appear to have grown.

Because 3.28.710 states that employees are not obligated to pay additional contributions "because of amendments hereafter made to this [S]ystem," liabilities associated with benefit improvements cannot justify Measure B. In any event, however, the Federated Plan's package of benefits have been nearly static since its inception. (*Compare* Exhs. 367; 368; 369; 332; 331; 334; 335; 336; 337.)

Indeed, the only benefit improvement to the Plan in the past thirty years was an actuarially neutral change from a capped to a fixed COLA. (Tr. 352; 512). This improvement was cost-neutral because the Plan merely changed its terms to match the actuarial assumption inherent in the former capped-and-banked COLA benefit. (Tr. 353-54 (Doonan); Tr.239 (Lowman); Exhibit 444 (finding adoption of fixed COLA was cost-neutral).) This is significant because it means that for decades, employees were contributing towards the cost of a 3% COLA, prefunding it under the entry age normal method such that there was no actuarial liability associated with retroactive application of the guaranteed 3%. (Exh. 398, p. 11). The other minor enhancement was the 1999 change in final average compensation from an average of 36 months to the highest 12 months (Tr. 352:26-28; 353:1-4), which resulted in an additional cost of just 1.15% of payroll (Tr. 353). As Chart A indicates, for several years after the compensation change, the Plan's funded status actually increased.

In sum, Measure B seeks to impose obligations for plan experience and amendments, which the Municipal Code has specifically provided are the obligation of the City.

c. Alterations to the Defined Benefit System

As described, above, AFSCME members automatically become members of the Federated City Employees' Retirement System upon becoming full-time City employees. (SJMC § 3.28.400, *et.*

*seq*.) Measure B makes substantial changes to the System and the benefits afforded thereunder, as discussed below.

*i. Suspension and Reduction of COLA*

Sections 1507-A(b)(v), 1507-A(e)(iii), and 1510-A of Measure B constitute an unconstitutional impairment of contract by impairing employees' and retirees' right to a fixed 3% annual COLA. A COLA provides retirement security by keeping retirement salaries at par with the cost of living. Without a COLA, a retiree's pension stays flat for the duration of the pension (Tr. 488:17-20) and it will not keep up with the cost of living, assuming inflation occurs as it always has (see Exhs. 502-505). Because the COLA compounds (Tr. 46:16-18, 451:16-18), as does inflation, a pension that does not receive a COLA adjustment in a particular year will lag behind the cost of living in subsequent years and is diminished over time.

Below, we demonstrate that AFSCME's challenge to Measure B's COLA provisions are ripe for adjudication and that the COLA is a vested pension benefit by nature. However, even if it were not, the evidence demonstrates that the City treated is as a vested benefit by making it available in perpetuity. Finally, we demonstrate that both the VEP and Tier 1 pension COLA provisions are unconstitutional pursuant the pension benefit jurisprudence discussed *supra*.

*aa.* <u>COLA Challenge is Ripe for Adjudication</u>

Despite the City's contentions to the contrary, AFSCME's facial challenge to sections 1507-A(b)(v), 1507-A(e)(iii), and 1510-A of Measure B is ripe for adjudication because it addresses a probable future controversy relating to the rights and duties of the parties for which declaratory relief is appropriate.

In relevant part, AFSCME seeks declaratory relief pursuant to Code of Civil Procedure section 1060 and the "'actual controversy' language in [that] section … encompasses a probable *future controversy* relating to the legal rights and duties of the parties." (*County of San Diego v. State* (2008) 164 Cal.App.4th 580, 606 (emphasis added).) In fact, the purpose of declaratory relief is "to set controversies at rest before they lead to repudiations of obligations, invasion of rights or commission of wrongs…. It is to be used in the interests of preventative justice to declare rights rather than execute them…." (*Environ. Defense Proj. v. Sierra* (2008) 158 Cal.App.4th 877, 884 (citations omitted) (hereinafter "*Sierra*").)

Courts may also resolve disputes if the consequence of a deferred decision will create an uncertainty in the law, and "[i]f the issue of justiciability is in doubt, it should be resolved in favor of justiciability in cases of great public interest." (*National Audubon Society v. Superior Court* (1983) 33 Cal.3d 419, 433 fn.14 (citing cases).)

The legality of Measure B's COLA provision is an issue of great public concern and a failure to adjudicate its legality at this time would leave City employees, Federated retirees, and taxpayers, in a state of lingering uncertainty. With respect to City employees, a suspension of the COLA would result in a flattening of the pensions they receive for the duration of the suspension (Tr. 488:17-20), thereby devaluing the pension benefit and leaving them with a diminished pension benefit. More broadly, this issue is of great public interest because it concerns the expenditure of public finances.

Furthermore, the court in *Sierra*, *supra,* 158 Cal.App.4th at 886, held that an "actual controversy" existed where the parties had "different interpretations of the Government Code" that a policy allegedly violated and where the county "made it clear that it [would] continue with" it's planned action notwithstanding the disagreement. (*See also Alameda County Land Use Assoc. v. Hayward* (1995) 38 Cal.App.4th 1716, 1723 ("An action for declaratory relief lies when the parties are in fundamental disagreement over the construction of particular legislation, or they dispute whether a public entity has engaged in conduct or established policies in violation of applicable law.") (citations omitted).)

At trial, City Manager Debra Figoné admitted that the City believed that Measure B's COLA provision was effective and that the City "is telling potential creditors that the … [COLA] provision of Measure B is effective and could be utilized by the City…." (Tr. 676:23-28; 677:1-11.) It is clear that the City continues to believe that the COLA provision is lawful. Pursuant to the aforementioned authority, these facts are sufficient to create a justiciable controversy.

Importantly, in its federal complaint for declaratory relief which it filed July 5, 2012, the City admitted that the entirety of the legislation presented a controversy that was ripe for adjudication: "An actual controversy has arisen and now exists between the parties relating to the legality of Measure B for which the City desires a declaration of rights…." (Exh. 632, ¶ 6.)

Finally, the City's citation to *City of Santa Monica v. Stewart* (2005) 126 Cal.App.4th 43, 63-66 (hereinafter "*Stewart*") in its Pre-Trial Brief, in support of its ripeness argument is unavailing because that case is distinguishable. In relevant part, the lawsuit in *Stewart* challenged a voter initiative seeking "to prevent city officials from receiving certain advantages from persons or entities who derived benefit from discretionary decisions made by those officials." (*Id.* at 50.) The City Clerk informed the City Council that she was refusing to enforce the Initiative until its constitutionality was determined, and, as a result, the City filed an action for declaratory relief and writ of mandate against its City Clerk. (*Id.* at 53.) The court held that the claim against the Clerk was not ripe for adjudication because, in part, "no showing ha[d] been made that the Clerk 'ha[d] any remaining duties or obligations under the Initiative such that her asserted 'refusal' to implement the

Initiative has any legal effect sufficient to support th[e] action.'" (*Id.* at 64.) To the contrary, in this case, Measure B requires the City Council to implement ordinances and to enforce the provisions of the voter referendum, such as the COLA provisions. Therefore, unlike in *Stewart*, AFSCME's challenge to Measure B's COLA provisions, as well as each and every other one of its provisions, is ripe for adjudication.

*bb.* COLA is Constitutionally Protected Pension Benefit

In 2006, the City amended the Federated COLA provision to *guarantee* a three percent annual adjustment. (SJMC§ 3.44.160; Exh. 5101, p. 14 (SJ000024).) At that time, City employees earned a vested right to the guaranteed COLA benefit since enhancements to vested pension benefits become part of the protected contract right. (*See Betts, supra,* 21 Cal.3d at 530.) More significantly, even prior to the 2006 amendment members had been contributing to the cost of a 3% COLA benefit, because prior to 2006 the COLA benefit was capped at 3% with excesses banked, and so in 2006 the plan merely changed its terms to match the existing actuarial assumption (Tr. 353-54 (Doonan); Tr.239 (Lowman); Exhibit 444.) Because the plan utilizes an entry-age normal method of prefunding benefits (Exh. 398, p. 11), the 3% COLA has been paid for by employees since the inception of the plan, and is subject to the same contribution rate as the service pension benefit (*See* SJMC § 3.44.160(A)(1); *Compare* SJMC, § 3.44.100(C) *with* SJMC, § 3.28.860.)

California courts have repeatedly held that COLA benefits are protected by the Contracts Clause in the same way that any other retirement security pension provisions are protected. (*LA Fire*, *supra*., 210 Cal.App.3d 75 (unconstitutional to cap pension COLA for current employees); *Pasadena Police, supra,* 147 Cal.App.3d at 702 (amendments to COLA "substantially limited and reduced the protection which had previously been offered."); *Wills, supra,* 187 Cal.App.3d at 780.) Other state and federal courts have reached this conclusion. (*See, e.g. Hayden v. Hayden* (1995) 284 N.J.Super. 418, 665 A.2d 772, 774–75 ("post-retirement [COLA] increases are as much a part of the pension as the amounts initially established by the pension system on retirement"); *cf. United States v. Will* (1980) 449 U.S. 200, 229 (cost of living adjustment to judicial salaries vested when it took effect; applying U.S. Const. art. III, § 1); *Williams v. Rohm and Haas Pension Plan* (7th Cir. 2007) 497 F.3d 710, 713 (if pension plan entitles annuitant to COLA, it must also provide COLA's actuarial equivalent in one-time lump sum distribution).)

Where, as here, employees are not covered by Social Security (which includes a COLA escalator) (Exh. 5101, p. 1; Tr. 105:19-26; 379:12-15), the Federated system COLA is the only retirement income inflation insurance they have. Finally, the SJMC makes evident that the City intended to make the flat COLA a vested benefit:

> 1. Each retirement allowance and each survivorship allowance which is payable … *any subject year* which begins on or after April 1, 2006, together with any increases or decreases in the amount of any such [COLA] allowance …, *shall* be increased by three percent per annum…
> 2. Each increase *shall* become effective beginning with the allowance payable for the month of April *in each subject year*….

(Exh. 602, SJMC §§ 3.44160(A)(1), (2) (emphasis added); *see also* Exh. 630 (City Council's passing of Ordinance No. 27652 creating flat 3% COLA).)

Extrinsic evidence produced *before* the City Council approved the COLA Ordinance (No. 27652) confirms this fact. (*See Delta Dynamics, Inc. v. Arioto* (1968) 69 Cal.2d 525, 527-29 (courts should consider extrinsic evidence relevant to proving reasonably susceptible contract language); *see also* Com. Code, **§** 2202(b) (non-contradicting, supplemental parol evidence may be used to explain intent of parties to contract).) For example, an article appearing in a retirement services newsletter in January 2006 stated: "*Each year thereafter* on April 1, a flat 3% COLA adjustment will be made to those receiving the benefit on that date." (Exh. 520 (AFSCME001468) (emphasis added) (clarifying the phrase "in each subject year," was synonymous with "each year thereafter.").)

As held in *IBEW v. City of Redding*, language recognizing a benefit is provided in perpetuity is sufficient to create an express vested right. ((2012) 210 Cal.App.4th 1114, 1122.) Therefore, Federated members and retirees enjoy an express contractual right to a flat three (3) percent COLA.

*cc. Measure B Unconstitutionally Impairs These Vested Rights*

*1. The VEP COLA is Unconstitutional*

Section 1507-A(b)(v) of Measure B "unfixes" the benefit and caps it at 1.5% per fiscal year for employees forced into the VEP. (*See also* Section 1510-A(b).) Furthermore, in the event that the City suspends the COLA under authority of Section 1510-A, it can only restore the VEP up to 1.5% for those opting into the VEP. These same provisions apply to those retiring for a service connected disability retirement, as Section 1507-A(e)(iii) states that COLA provisions for such individuals "will be the same as for the service retirement benefit in the VEP."

As a result, there is no guarantee that participants in the VEP will even receive the lower 1.5% annual COLA, nor that this rate will keep pace with inflation. At trial, labor economist Dan Doonan testified that based upon his review of historical CPI average, he concluded that a 1.5% COLA is lower than the historical CPI amount as calculated by the Bureau of Labor Statistics. (Tr. 358:12-23; *see also* Exhs. 487, 503-505 (demonstrating historical CPI trends and admitted to explain basis for expert's testimony).) Because the VEP COLA provision reduces the pension benefit to an amount that does not keep pace with inflation, is far lower than the three (3) percent COLA to which

members earned a vested and does not provide members with the missed COLAs, it amounts to a substantial devaluation of the COLA benefit. As such, it constitutes an unconstitutional impairment of contract.

*2. The Tier 1 COLA is Unconstitutional*

Furthermore, without defining what constitutes a "fiscal and service level emergency," Section 1510-A of Measure B grants the City Council unbounded discretion to determine and declare such an event and, upon doing so, suspend for up to five years all COLA payments to retirees, whether they stayed in the Tier 1 plan or transitioned to the VEP. In the event that it restores *all or part* of the COLA after suspending it in such a fashion, Measure B *caps* it at three percent for those staying in the Tier 1 plan and 1.5% for those in the VEP; the COLA rates would not continue to be a fixed percentage as they were prior to Measure B. (Measure B, Section 1510-A.) Therefore, if the City Council suspends altogether or otherwise grants a COLA below the three percent (3%) guaranteed level in any given year, it defies employees' reasonable pension expectations. Because of the compounding nature of COLA (and inflation), employees subject to a reduced COLA will never make up the suspended COLA.

Section 1510-A also does not require the City to demonstrate that suspending and eliminating the benefit is a "reasonable [and necessary] measure" directed at resolving the crisis, thereby violating the principles enunciated by the Supreme Court in *Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 310. Therefore, Section 1510-A's "fiscal emergency" clause does not save it from being deemed unconstitutional as an impairment of contract.[4]

Because Measure B's COLA amendments substantially impair members' pension expectations without providing a commensurate benefit, sections 1507-A(b)(v), 1507-A(e)(iii), and 1510-A of Measure B constitute unconstitutional impairments on contract in contravention of Cal. Const. Art. I, sect. 9.

*ii. Elimination of SRBR Benefit*

Section 1511-A of Measure B eliminates an established pension benefit and its trust account and then raids the *rest* of the trust account to offset the City's general funding obligations. The SRBR is a "13th Check" benefit, a form of inflation protection available to retirees in the event that excess earnings exist in the operating account of the System after payment of all administrative costs

[4] AFSCME also incorporates as though fully set forth below the discussion forwarded by the San José's Police Officers' Association ("POA") in its Pre-Trial brief with respect to Section 1510-A's vague delegation of authority to the City Council to suspend COLA payments for up to five (5) years upon declaring a fiscal emergency. (See POA Pre-Trial Brief, pp. 20:3-28; 21:1-5.)

and expenses. The allocation to the SRBR benefit consists of 10% of the excess earnings remaining in the System's operating account (the other 90% are deposited in the System's general fund). (SJMC § 3.28.340(D).) Although they have no bearing of the legal issue of whether Measure B violated constitutional rights by eliminating the SRBR, the City's contentions regarding the nature of the benefit and recent bargaining over it are without merit, as discussed below.

*aa. Measure B Unconstitutionally Eliminates the SRBR Benefit*

The City failed to provide plan members a commensurate benefit when it eliminated the SRBR but did not use the savings from the elimination to their benefit. Through this action, it also violated the PPA's command and general trust law principles stating that pension plan assets be used exclusively for the benefit of plan members.

California Trust law, contained in the state Constitution's Pension Protection Act (Art 16, sect. 17) as well as the SJMC, prohibits eliminating and appropriating the assets of the SRBR. The SRBR was created for the benefit of Federated retirees, as it "shall be used only for the benefit of retired members, survivors of members, and survivors of retired members." (SJMC § 3.28.340(E)(1); *see also* SJMC § 3.28.340(E)(2).) Former MuniCode section 3.28.070(B)(4) provides further evidence that the monies within the SRBR funds belonged to plan members rather than the City. Before Measure B, that section required that the Board, upon termination of the pension plan, "[a]llocate any assets in the [SRBR] … to the then existing retired members, survivors of members, and survivors of retired members …." (SJMC, § 3.28.070(B)(4).)

Article 16, section 17(a) of the Constitution, states: "The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." (*See also Keitel v. Heubel* (2002) 103 Cal.App.4th 324, 337 (discussing elements of express trust) ("*Keitel*"); *City of Palm Springs v. Living Desert Reserve* (1999) 70 Cal.App.4th 613, 619 ("The legal title of the res or corpus of any trust is held by the trustee, but the beneficiaries own the equitable estate or beneficial interest") ("*Palm Springs*").)

When the City liquidated the Fund in 2012, it incurred a fiscal-year budget savings of approximately $13 million (Tr. 936:8-21); that is, the SRBR funds offset what it would have otherwise been required to pay into the retirement system for that year. By using the SRBR trust fund to its own advantage, the City acted unconstitutionally. Alex Gurza testified that the goal of Measure B was to move SRBR funds to the main retirement trust fund in order to reduce future contributions of the City (Tr. 935:14-21; 936:8-21). Yet this *did not* impact the retirement contribution rate of individual employees nor retirees (Tr. 935:14-21). Mr. Gurza stated that the

elimination of the SRBR benefited employees, retirees, and members of the Federated plan because "it assists the funding status of the plan" and because it resulted in a "modest restoration of services." (Tr. 936:22-28; 937:1-11.) However, an improvement in the plan's funding status benefits the City rather than employees because the City must pay retirees the promised defined benefits regardless of the funding status of its plan. (*See Bellus, supra,* 69 Cal.2d at 336.) Furthermore, any restoration of services benefits plan members as City residents, rather than plan members, and the PPA and trust law only address rights as employees.

Therefore, although the City's retirement costs decreased as a result of the cost savings, plan members' *did not* realize a cost saving. Not only did the City's failure to use the SRBR funds to the advantage of plan members violate the PPA, but it also violated MuniCode sect. 3.28.070(B)(4), which specifically required that SRBR assets be allocated to retirees, survivors of members, and survivors of retirees upon plan termination. (*See also* SJMC, § 3.28.070(C) (requiring retirement fund assets to be credited to plan members upon the termination of the plan and satisfaction of plan liabilities).)

The trial presentation focused on the "asymmetrical" nature of SRBR's funding which, in laymen's terms, means that the benefit was not properly actuarially accounted. The City relied on *Claypool v. Wilson*, to justify the elimination and raid of the SRBR trust, arguing, yet in that case the court upheld the elimination of a separately funded COLA trust only because in doing so the pension system adopted a commensurate COLA component to the service annuity. ((1992) 4 Cal.App.4th 646, 658 ("*Claypool*")). Thus the *Claypool* court noted, "[T]he saving of public money is not an illicit purpose if changes in the pension program are accompanied by comparable new advantages to the employee." (*Id.*) Here, SRBR is eliminated but no replacement benefit is adopted.

In a similar case, *Wayne County Employees Retirement System v. Charter County of Wayne,* (Mich.App. May 9, 2013) 2013 WL 1920732, a Michigan appellate court found unconstitutional the liquidation of an SRBR-type benefit, an "Inflation Equity Fund" or "IEF," that provided occasional 13th checks predicated on excess investment earnings, even though the law did not mandate annual distributions to retirees. The Court noted the fund "can be accurately characterized as a vested reserve belonging and in relationship to the Retirement System's participants as a whole, outside the reach of [the county], to be used to assist retirees and survivor beneficiaries in fighting the devaluing of the dollar by inflation." (*Id.*) Here too, the SRBR was adopted for that purpose (Ex.5412 & 570 (SRBR intended as an "ad hoc" cost of living benefit, modeled under similar benefits in state and county pension plans, and anticipating the cost of SRBR would be shifted to the normal contribution rate.) Just as here, in *Wayne County* the court found the elimination of the IEF unconstitutional,

noting "Instead of honoring and protecting the IEF in connection with its designed purpose, the County Board improperly invaded the assets of the IEF to lessen its financial burden with respect to [Annual Required Contributions]… dipped into assets that had already been set aside for a particular purpose pursuant to the requirements of previous provisions of the IEF Ordinance." (*Id*. at *17; see also *McCall v. State,* (1996) 640 N.Y.S.2d 347, 219 A.D.2d 136, 142 (an ancillary Supplemental Reserve Fund was "indisputably an asset of the retirement system" and not subject to liquidation).)

Here, the SJMC provides that the City Council retains discretion over the distribution of SRBR assets, the SJMC and resolutions set forth a process by which SRBR distributions to retirees are made from the SRBR Trust "if any" assets are held in the trust. The City Council does not retain ultimate discretion, but rather must administer the retirement trust in accordance with fiduciary principles arising under the Article 16 of the Constitution. Therefore, although the Municipal Code provides discretion to "determine the distribution," it does not mean the benefit is entirely discretionary or that a contractual obligation has not arisen. Under California law, an obligation under a contract is not illusory if the obligated party's discretion must be exercised with reasonableness or in good faith. (*Storek & Storek, Inc. v. Citicorp Real Estate, Inc*. (2002) 100 Cal.App.4th 44, 61; *Third Story Music, Inc. v. Waits* (1995) 41 Cal.App.4th 798, 806 ("the implied covenant of good faith is also applied to contradict an express contractual grant of discretion when necessary to protect an agreement which otherwise would be rendered illusory and unenforceable.").) Here, the fact that the SRBR establishes a trust for the exclusive behalf of retirees, to which Article 16 of the Constitution imposes fiduciary obligations, the discretion conferred to designate the amount of benefit must be exercised in good faith and in accordance with fiduciary principles.

Importantly, the SJMC does not confer discretion to discontinue or eliminate the SRBR trust account or the benefit itself. Nor does "the greater power imply the lesser power," an argument rejected in *Legislature v. Eu*, where the electorate attempted to terminate the Legislators' Retirement Law ("LRL") with respect to incumbent legislators. ((1991) 54 Cal.3d 492, 528-534.) In that case, the "lesser power" reserved to the legislature to limit retirement benefits payable to legislators, did not imply the greater power to terminate them, and so completely repealing a benefit was unconstitutional. (*Id.*; *Kern v. City of Long Beach* (1947) 29 Cal.2d 848.) Certainly the City viewed the SRBR benefit as vested, and advised retirees of this fact. A newsletter article from 2003 entitled "SRBR Update" stated that the "[o]bjective of this new [SRBR] methodology is to create a program that will provide an annual, additional payment for retirees and to fix a minimum level of the SRBR to insure that the program *can go down in perpetuity*." (Exhibit 354, p. 1 (AFSCME001457) (emphasis added).)

As such, Section 1511-A of Measure B constitutes an unconstitutional impairment of contract.

*bb. The City's Justifications for Elimination Do Not Bear on the Legal Issues in This Case and Are Therefore Without Merit*

The City may aver that Measure B's elimination of the SRBR was justified because it provided an "irrational" benefit, meaning it was not properly costed, and because AFSCME tentatively agreed to the SRBR elimination during bargaining. Both arguments stretch credulity, and neither bears on the issue of whether Measure B violated constitutional rights by eliminating the SRBR, especially given the fact that the City is not asserting a fiscal emergency justification. (Exh. 6071; Tr. 1013:16-28; 1014:1-9).

*cc. SRBR is Neither an Uncommon Nor Irrational Benefit*

Despite the City's contentions to the contrary, the SRBR--a benefit funded by both member and City contributions (Tr. 244:11-14)--is neither an unusual nor irrational benefit. Rather, its funding mechanism was subjected to some debate and criticism within the actuarial field. (Tr. 973.) However, this is an improper and truly novel basis on which to assert the benefit is not vested.

First, both plaintiffs' and the City's expert actuaries acknowledged that San José is not the only jurisdiction that offered an SRBR-type, or "gain sharing," benefit. (Tr. 215:8-14; 973:27-28; 974:1.) Mr. Lowman, stated "[t]here are many gain-sharing plans around the country." (Tr. 215:8-14.) Indeed the SRBR was "patterned on State legislation that had been adopted in 1983." (Exh. 446, p. 1 (AFSCME003677).) Additionally, several California court decisions have considered constitutional issues surrounding such SRBR-type plans (*see, e.g., City of San Diego v. Haas* (2012) 207 Cal.App.4th 472; *Teachers' Retirement Bd. v. Genest* (2007) 154 Cal.App.4th 1012 (hereinafter *Genest*), and the *Genest* court held unconstitutional legislation reducing state's obligation to fund CalSTRS gain-sharing plan.

More importantly, it became apparent at trial that the City objected to the manner of funding the benefit rather than the benefit itself. To that point, Mr. Lowan testified that the SRBR was only problematic when it was not funded correctly. (Tr. 289:16-23.) John Bartel, the sole expert actuary presented by the City (Tr. 961:2-25), testified consistently by clarifying that it was *not* his opinion that the benefit provided under the SRBR program was flawed. Rather, he believed that the *cost of the benefit* was not properly considered by the actuaries advising the retirement board. (Tr. 973:27-28; 974:1-2, 7-12.) Importantly, Mr. Lowman also testified that the "asymmetrical" funding of the benefit did not violate any actuarial standards in terms of benefit design. (Tr. 215:8-25; 297:15-28; 298:1-2.) Obviously, AFSCME has no control over how the retirement board solicits and responds to

actuarial advice. Mr. Bartel did testify that he believed that although there was an effort to specifically fund the SRBR, that effort was sparse. (Tr. 975:2-5.) Documentary evidence supports the fact that the cost of the SRBR was regularly considered and measured (*See, e.g.,* Exhs. 400, p.27; 401, p.28; 402, p.7; Exh. 5703, at SJRJN 00456).

*dd.* *Actuaries' Failure to Properly Cost the Benefit Does Not Justify Elimination of the Benefit*

The City also elicited testimony that the SRBR benefit was not properly costed when adopted. To support this argument, the City pointed out that Plan actuaries did not associate a cost with the SRBR until the June 30, 2011 valuation (Tr. 968:4-10), and that historical Board resolutions providing for funding were inadequate (Tr. 974:20-28; 975:1-5.) However, this is neither the fault of AFSCME nor its members, because, while the SRBR account is funded by member and city contributions to the Federated pension plan (Tr. 244:2-14), the retirement Board is responsible for setting contribution rates for its retirement plans (SJMC, § 3.28.200). Furthermore, Governmental Accounting Standards Board ("GASB") accounting rules do not require reporting of the SRBR benefit. (Tr. 355:8-28; 356:1-7.) Therefore, the failure to cost the benefit in the early years was not unprecedented. Additionally, despite Bartel's averments to the contrary, the plan's actuaries believed that the benefit may have actually been implicitly funded in prior years by way of setting a lower discount rate. (*See* Tr. 290:9-28; 291.) As stated above, the Board was certainly informed of and aware of the benefits cost.

Regardless of whether or not the SRBR was previously costed, the fact that actuaries began costing it in 2011 amply addressed the City's concerns with respect to the price tag on the SRBR. Importantly, Mr. Lowman testified that he was satisfied that the plan actuaries began costing the SRBR benefit in 2011 and that reduced his concern over the fact that it might not have been accounted for previously. He believed that the funding method employed by the actuaries in 2011 would lower the employees' costs with respect to the SRBR. (Tr. 294:19-28; 295:1-16.) Therefore, the City's concerns with respect to the failure to cost and properly fund the SRBR benefit are no longer legitimate and did not justify elimination of the trust.

*ee.* *AFSCME's Tentative Agreement to SRBR Proposal Did Not Affect the Vested Nature of the Benefit*

The City's argument that Section 1511-A is valid because AFSCME executed a "tentative agreement" to eliminate SRBR is simply a red herring predicated on a mischaracterization of the significance of the term "Tentative Agreement" in labor negotiations.

Charles Allen, the business representative assigned to AFSCME Local 101, testified that

he was part of the team that bargained over retirement benefits with the City in 2011. (Tr. 375:4-20; 996:18-23.) As part of those negotiations, the City proposed eliminating the Federated SRBR. These proposals culminated in Tentative Agreements ("TAs") between the AFSCME bargaining units and the City. (Exhs. 5713-14; Tr. 996:24-28; 997:1-3, 20-27.)

Alex Gurza, who was not present at the negotiations over the SRBR, testified that the purpose of a Tentative Agreement was to resolve a smaller issue as part of the larger effort to reach an agreement on the overall negotiation. (Tr. 770:4-12; 771:4-15; 911:23-28; 912:1-15.) He further testified that TAs are generally contingent upon an overall agreement, ratification of that agreement by the bargaining unit, and approval by the City Council. (Tr. 771:16-24; 815:2-23.) In support of this view, Dr. Allen testified that the AFSCME bargaining units signed the SRBR TAs "with a view to a good-faith effort to move negotiations forward and in anticipation of the receipt of something of comparable worth." (Tr. 999:14-26.) A tentative agreement constitutes a part of the give-and-take of bargaining, allowing the parties to build trust and make tentative concessions. Again, AFSCME did obtain anything of comparable worth on behalf of members or retirees, as the parties were unable to reach an agreement on retirement benefits (Tr. 889:9-22.)

*iii. Redefinition of Disability Benefit*

AFSCME members do not receive disability insurance through Social Security, and have no other disability insurance than that afforded under the Federated System's disability provisions. Measure B constitutes an unconstitutional impairment of contract by impairing their vested disability retirement expectations. Furthermore, the City's contention that disability retirement abuse justified this impairment is without merit. First, it has no bearing on the constitutional question before the Court and, as a factual matter the City furnished no evidence demonstrating that the disability retirement process was abused within the Federated System, but conceded there was nothing concerning regarding Federated disability retirement usage (Tr. 517).

*aa. <u>Measure B Impairs Vested Rights to Disability Retirement</u>*

The City does not deny that Measure B alters the nature of the disability retirement benefit. (Tr. 477:5-11; Exh. 5013, p. 33 (SJ001573).) For employees forced into the VEP plan, Measure B dramatically reduces the disability annuity formula and COLA. (*Compare* SJMC, §§ 3.28.1210, .1280 & .1300 *with* Measure B section 1507-A(e).)

Measure B also imposes restrictions on what is considered a "Disability." In short, it restricts the eligibility for disability retirement to those whose disability is either expected to last more than

one year or will result in death and who cannot perform *any* jobs for the City as a result of disability (Measure B section 1509-A), even if there is no vacancy in the classifications within the City. In a way, this permits the City to manipulate its disability pension liabilities by determining whether there are openings in such classifications. Further, for employees forced into the VEP, the amount of the benefit is dramatically reduced under Section 1507-A(e) of Measure B which limits service-connected disability to fifty percent of pay and non-service connected disability to twenty-five to fifty percent of pay, depending on years of service. Prior to Measure B the retirement board had authority over all pension eligibility determinations, including disability pensions, whereas Measure B revokes that authority and grants it to a medical review panel. (Section 1509-A(c).)

The City relies on *Claypool, supra,* 4 Cal.App.4th at 670, 680, to justify these changes, arguing that "plaintiffs do not have a vested right in administering the disability retirement program." However, *Claypool* implicitly supports Plaintiff's position because in that case, there was "no ground for implying a statutory promise that the duty of performing of these functions would not be transferred to another entity." Here the SJMC contains a clear command that retirement board is to consider and grant such retirements. (SJMC § 3.28.1220, *et seq.*) This due process right is significant, because the retirement Board consists of management, employee and retiree representatives and, therefore provides a balanced decisional panel. (SJMC, §§ 2.08.1000; 2.08.1010; 3.28.100.) The right to have the retirement Board perform the functions is meaningful and established by express contract.

The City represented the disability retirement system to its employees in a manner that affirms the inference of vested rights. For example, a brochure entitled "Disability Retirement," described the disability retirement process under the Federated System with citations to the Municipal Code. Amongst other representations made, it stated:

> If you are disabled, a disability retirement may be granted if:
>
> - Your disability is of permanent or extended and uncertain duration
> - Your disability occurred while you were an employees of the City and a member of the Federated Retirement System
> - Your disability, due to injury or disease, renders you physically or mentally incapable of continuing to satisfactorily assume the responsibilities and perform the duties of your position and any other position in the same classification of positions *to which the City may offer to transfer you*
> - The determination of disability *is made by the Retirement Board on basis of competent medical opinion*.

(Exh. 344 (AFSCME002578) (emphasis added).)

For decades, the City, through retirement system newsletters and handbooks, made similar representations to retirement system members regarding the qualifications for disability retirement as well as the process by which applications are considered by way of its. (*See, e.g.,* Exh. 351 (AFSCME002708 (retirement services newsletter article thoroughly discussing disability retirement process and stating, in relevant part, that application is withdrawn if employee is placed on permanent modified duty within his/her department and pointing out that Retirement Board decides whether to grant disability retirement based on "objective, medical evidence as to whether an employee is disabled"; Exhs. 328, 329, 636, 655, 706, 707 (retirement system handbooks dating from 1990 through 2004).)[5]

That a public employee's pension constitutes a vested right upon acceptance of employment "applies with equal force to disability pensions." (*Gatewood v. Board of Retirement* (1985) 175 Cal.App.3d 311, 319-20; *Cochran v. City of Long Beach* (1956) 139 Cal.App.2d 282, 286 (applying *Allen* to change in disability retirement); *see also Newman v. City of Oakland Retirement Bd.* (1978) 80 Cal.App.3d 450, 458, ("It is well settled that retirement benefit rights including pensions whether for age and service, disability or death are vested.").) In fact, the court in *Frank v. Board of Administration* (1976) 56 Cal.App.3d 236 stated:

> No reason exists in plaintiff's case to apply a different rule to disability retirement benefits than to service retirement benefits. We therefore hold that the *plaintiff acquired a vested contractual right to a reasonable disability retirement pension when he entered upon performance of his employment contract with the state*.

(*Id.* at 241–243 (emphasis added).) Because general pension eligibility rules are a vested component of the pension contract, so too are the eligibility rules of a disability retirement. Thus changes to a disability benefit are treated no differently under *Allen* and its progeny than any other component of a pension annuity. (*Babbitt v. Wilson* (1970) 9 Cal.App.3d 288, 290; *see also Pasadena Police, supra,* 147 Cal.App.3d at 703.)

Although AFSCME has not found California precedent addressing changes to disability pension eligibility rules, the Supreme Court of Alaska has considered the issue and determined: "Regarding the change in eligibility requirements for occupational disability benefits, the court rejected the state's argument that eligibility standards were not part of the vested benefits" as the vested benefits necessarily include not only the dollar amount of the benefits payable, but the requirements for eligibility as well, regarding "it as self-evident that this change will entail

[5] This evidence also supports AFSCME's contention that the City should be estopped from denying any disability retirement benefits it promised members.

serious disadvantage" to certain injured public safety employees. *(Hammond v. Hoffbeck* (AK 1981) 627 P.2d 1052, 1507.)

For the aforementioned reasons, Sections 1507-A(e) and 1509-A constitute unconstitutional impairments of contract.

*bb.* The City's Justification for Changes to Disability Pension Lack Merit

At trial, the City averred that it was necessary to "reform" the disability retirement process because of abuse. (Tr. 470:22-28; 471:1-4.) While irrelevant under a vested rights analysis, the assertion lacked any factual support with respect to the Federated System; in fact, the evidence demonstrated the contrary.

The City Auditor's disability retirement report disclosed that the Federated retirement Board only heard 108 disability retirement applications over eleven years (Exh. 5013, p. 16 (SJ001556).) City Auditor Erickson testified that while the average approval rate for disability retirements in other jurisdictions was 80% to 82%, the average approval for the Federated System was only seventy-72%. (Tr. 470:2-18; Exh. 5103, p. 20 (SJ001560).) Ms. Erickson's report disclosed that in 2011, only 6% of Federated retirees were receiving disability retirement benefits. (Exh. 5013, pp. 9-10 (SJ001549-SJ001550).) Finally, Ms. Erickson testified that Federated employees already receive an offset to their disability retirement pensions of the amount of any workers' compensation payments received (Tr. 480:2-15; *see also* Exh. 344 (AFSCME002578), eliminating the possibility of receiving double payments or an unintended advantage. It must also be noted that the Federated disability benefit is offered in lieu of the Social Security disability component of Old Age, Survivorship, Disability Insurance program. The City provided no evidence that disability rates under that system are less generous than the Federated System.

*iv. The Hobson's Choice "Voluntary Election Plan"*

Despite its name, the "Voluntary Election Plan," created by Section 1507-A[6] of Measure B does not actually provide Federated members with a choice. The VEP significantly reduces benefits afforded prior to Measure B without providing any sort of commensurate benefit. Therefore, it constitutes an unconstitutional impairment of contract. Together, Sections 1506-A and 1507-A require employees to opt-into lesser "second tier benefits" (Tier 2) or alternatively forego a large portion of their wages for the purpose of paying system UALS.

[6] The City admitted at trial that it would not implement the VEP plan without IRS approval and that the plan has not yet received such approval. (Tr. 25:17-18; 26:1-9.) If the VEP is not approved, it is likely that Federated members will be stuck with the Tier 1 plan as effected by Measure B.

*aa. VEP Plan Constitutes Unconstitutional Deprivation of Vested Rights*

The VEP does not preserve benefits earned under the former tier because it requires a longer amount of time for members to achieve the same level of benefits they were originally promised, and because it entitles retirees a lower dollar amount in pension benefits in any given year. As one witness testified, the VEP does not present a better alternative to the Tier 1 plan because under "the so-called volunteer program, [he] would not be able to retire at 55" as he had originally planned, "and to reach the same goal, [he] would have to work longer to get the same [benefit accrual rate]." (Tr. 109:27-28; 110:1-12.)

Prior to Measure B, Federated members were able to retire after thirty years of service or after five (5) years of service at age 55. (SJMC, § 3.28.1110(A); Exh. 343.) Upon retirement with thirty years of service, Federated System members were entitled to earn up to 75% of their final compensation (SJMC, § 3.28.1110(B); Exh. 343) as well as the COLA benefit (SJMC, § 3.44.160(A)). "Final compensation" was defined as the:

> highest average annual compensation earnable by the member during any period of twelve consecutive months of federated city service, including time prior to entering federated city service at the compensation earnable by the member in the position first held by him or her in such service as may be necessary to complete twelve consecutive months….

(SJMC, § 3.28.030.11(B).) Furthermore, members were credited with one year of service for each year in which they worked 1,739 hours. (SJMC, § 3.28.680(B).)

With respect to service connected disability retirement, qualified plan members could receive a base retirement allowance of at least forty (40) percent and up to seventy-five (75) percent of final compensation. (SJMC, § 3.28.1280(B); Exh. 344.) A non-service connected disability retirement benefit was 2.5% of final compensation for each year of service with an offset of 0.5% per year for each year the retiree was under the age of fifty-five (55). (SJMC, § 3.28.1300; Exh. 344.) The three 3% guaranteed COLA was also payable on the amount of the disability retirement benefit. (SJMC, §§ 3.44.010(B); 3.44.160(A).)

Measure B's VEP Tier 2 plan constitutes a significant impairment of vested pension rights because it:

- Increases the service retirement age from fifty-five to sixty-two (Section 1507-A(b)(iii));
- Raises eligibility for service retirement from thirty years of service by six months annually) (Section 1507(A)(b)(iv));
- Reduces the pension annuity formula with respect to such employees' future service from 2.5% per year of service to 2% (Section 1507-A(b)(i));

- Redefines the average compensation on which the pension annuity is formulated from the highest twelve consecutive months to the average of highest three years of pay (Section 1507-A(b)(vi));
- Increases the number of hours that constitute a year of service from 1,739 to 2,080 (Section 1507-A(b)(vii));
- Reduces survivorship benefits available for death before retirement as well as for a spouse or domestic partner and/or children designated at the time of retirement (Section 1507-A(d)(i), (d)(ii)); and
- Significantly extends the minimum service or vesting requirements.

As previously demonstrated, it reduces inflation protection by capping the COLA at 1.5% and redefines the criteria for a disability benefit. (Sections 1507(b)(v), (d), (e).) These changes instituted by Measure B redefine retirement eligibility requirements and diminish the value of each year of service worked by leaving plan members with less money than expected in retirement benefits for each year of service performed without providing a commensurate benefit.

Any attempt by the City to justify subsections (b)(iii) and (b)(iv) of Section 1507-A under authority of *Miller v. State* is unavailing. (*Miller v. State* (1977)18 Cal.3d 80.) That case did not involve pension rights, but merely public servants' mandatory retirement age (which was lowered). The court held that the legislature could reduce the tenure of civil servants (*Id*. at 813, 814.) *Miller* focused on the fact that public employment is governed by statute, rather than contract, and public employees have no contractual right to continued employment. Indeed here, the SJMC provides that the pension system does not guarantee any tenure of employment (*See, e.g.,* SJMC §§ 3.04.1150 (layoff provision for represented members); 3.04.1350 (defining 'demotion' and 'disciplinary action').)

Therefore, the legal authorities discussed in previous sections apply with equal force to the "Hobson's Choice" imposition of the VEP plan. Under such authorities, Section 1507-A constitutes a substantial impairment of the pension contract with no commensurable benefit to the employees.

*bb. VEP Plan Does Not Present a Voluntary Choice*

Although couched as a "voluntary" election, the VEP does not present employees with a free choice. Rather, Section 1507-A presents a City employee with two bad choices, and the only real option is in deciding which of those two bad choices will put him/her in a less worse-off position. As discussed below, one of the choices - paying towards the SJFRS' UAAL - is itself unconstitutional. Members who testified at trial did not believe they were presented with a choice. AFSCME member Jeff Rhoads testified that neither the changes made to the Federated Tier 1 pension plan nor the VEP

under Measure B present good options and that there is no "better" option amongst the two. (Tr. 190:27-28; 110:1-5, 12.)

In pertinent part, Section 1507-A states: "Employees who opt into the VEP will be required to sign an irrevocable election waiver … acknowledging that the employee irrevocably relinquishes his or her existing level of retirement benefits and has voluntarily chosen reduced benefits, as specified below." Thus, Measure B itself acknowledges that employees are entitled to these benefits, and seeks their waiver under a pain of penalty, that is, a wage excise against UAALs.

Although there are few case law authorities that consider the obvious: whether the Orwellian-named "voluntary" plan really provides a voluntary choice, some Courts have considered the term "voluntary" within the unemployment compensation benefits context. In such cases, employees were forced to choose between a "voluntary" and detrimental change of circumstances or remaining in the same situation and incurring a detriment. The court described such "voluntary" Hobson's choices as a "semantic sleight-of-hand that is irreconcilable with our charge to narrowly confine disqualifying exceptions . . . *This is compulsion.*" (*Nielson v. Employment Sec. Dept. of State*, (1998) 93 Wash. App. 21, 37-38 (emphasis added).) In *Pettypool v. Arizona Dept. of Economic Sec*. (1989) 161 Ariz. 167, where an employee presented with the "choice" of signing a Disciplinary Action Record ("DAR") that would reduce his wages, or not sign it which would act as a resignation, the court stated:

> Claimaint [sic] argues that *the employer presented him with a Hobson's choice*. He could either sign the DAR or not sign it. If he did, he would forfeit a portion of wages that he had already earned. If he did not sign the DAR, he would be deemed to have resigned. Since signing the DAR was a patently unreasonable alternative, claimant argues that the employer forced him to resign. Thus, claimant concludes that the DAR was effectively a request for resignation. *We agree*.

(*Id.* at 170 (emphasis added).) Here, employees who refuse to relinquish their right to receive the pension benefit to which they have worked toward and contributed are subject under the VEP provisions to a wage excise of up to sixteen percent. (Section 1506-A(b).) Employees have already suffered a twelve percent wage reduction in 2010, and many simply cannot afford the assessment remaining in their plan requires under Measure B's VEP provisions.

The VEP is especially troubling here because it involves relinquishing and reducing constitutionally-protected vested rights. A waiver of such a Constitutional right must be freely, voluntarily, and intelligently made. (*See In re Johnson* (1956) 62 Cal.2d 325, 335.) For this reason the VEP constitutes an unconstitutional impairment of contract as Measure B does not present a free,

un-coerced choice (or even an incentive to make that choice). As demonstrated above, it hardly suffices to merely label the choice as "voluntarily," where it is objectively clear that it is not.

**d. Alterations to Retiree Health Benefits**

Section 1512-A of Measure, pertaining to retiree healthcare, constitutes an impairment of contract by:

- "unvesting" the right to retiree health benefits; changing the definition of "lowest cost plan" in a way that reduces the promised subsidy towards the premium of retiree health;
- redefining the "low cost plan" in a manner that no longer entitles plan members to a retiree health plan free of high deductibles or other exorbitant costs;
- requiring active employees to contribute towards the City's unfunded liabilities ("UALs") with respect to retiree health; and
- leaving open the possibility that employees will contribute towards more than fifty percent of the cost of retiree health.

Because Measure B fails to provide its affected employees with a commensurate benefit to offset these detriments, Section 1512-A is an unconstitutional impairment of contract.

Like pension benefits, retiree health benefits may be considered deferred compensation, and an employee can become contractually vested in those benefits upon accepting employment. (*Thorning v. Hollister School District* (1992) 11 Cal.App.4th 1598, 1605-1606); *Sappington v. Orange County Unified School District* (2004) 119 Cal.App.4th 954; *see also* 83 Ops.Cal.Atty.Gen 14, 2000.) Once vested, an employee gains "an irrevocable interest in the benefit," which is treated as a form of deferred compensation in this state. (*REAOC, supra,* 52 Cal.4th at 1189 fn.3; *Thorning, supra,* 11 Cal.App.4th at 1605-1606.)

The *REAOC* court recently held that a public agency may create a vested right to retiree healthcare through express contact language, implied terms of a contract, or an implied contract, if there is no statutory prohibition against such arrangements. (52 Cal.4th at 1179.) They can also arise expressly or by implication under a collectively bargained MOU ratified or adopted by the governing body. (*REAOC, supra,* 52 Cal.4th at 1182.) Such is the case even when a contract is replete with explicit durational language or does not include vesting language. (*Sappington, supra,* 119 Cal.App.4th at 951, 955.) Here, because the retiree health benefit vested under the Code and attendant MOUs, it is explicitly vested.

"The principle that an employee begins earning pension rights from the first day he starts employment is not limited simply to pension cases but extends to other types of benefits." (*Thorning, supra,* 11 Cal.App.4th at 1606, 1607 (citation omitted).) This is one such case, as the Municipal Code provisions discussed below create vested rights to the retiree health benefits impaired by Measure B, and AFSCME MOUs dating back almost thirty years specifically incorporated these

Code sections pertaining to retirement benefits. (Exhs. 300-320; Tr. 376:20-24.) AFSCME members vested in their rights to retiree health benefits through both avenues.

*i. AFSCME Members Earned a Vested Right to Retiree Health upon Commencing Employment With the City*

Section 1512-A(b) of Measure B is unconstitutional because it attempts to un-vest a benefit in which AFSCME members have a vested right. The *Thorning* court held that the following policy granted the vested retiree health benefits in that case: "Any members retiring from the Board after at least one full term shall have the option to continue the health and welfare benefits program if coverage is in effect at time of retirement …." (11 Cal.App.4th at 1604-1605.) Similarly, the *Sappington* court concluded that language stating that the employer "shall underwrite the cost of [medical insurance] for all employees who retire" created a vested right to subsidized medical benefits. (119 Cal.App.4th at 951.)

As was the case in *Thorning*, that right to the expectation of health benefits vested in AFSCME members upon their first day of work. Failing to recognize a vested right on the part of San Jose employees would create an inequitable and unconstitutional paradox: while employees are required to contribute towards retiree health from the day they started working for the City, they were not guaranteed the benefit towards which they were paying. (*See* SJMC 3.28.385(C).) The court in *AFT Michigan*, in holding unconstitutional the state law unilaterally imposing upon teachers a three percent increase in contributions into a retiree healthcare funding account, stated:

> We cannot envision a court approving as constitutional a statute that requires certain individuals to turn a portion of their wages over to the government in return for a 'promise' that the government will return the monies, with interest, in 20 years when the government retains the unilateral right to 'cancel' the 'promise' at any time and does not even agree that, if they do so, the monies taken will be returned. School employees cannot constitutionally be required to 'loan' money to their employer school districts, with no enforceable right to receive anything in exchange and without even a binding guarantee that the "loan" will be repaid."

(*AFT Michigan,*297 Mich.App. at 635.)

In fact, the SJFRS' retiree health plan is a component of its pension system and is funded using actuarial methods, to which employees have contributed based on a normal cost calculation throughout the course of their employment. It follows, therefore, that just like pension benefits, "upon acceptance of public employment," AFSCME members "acquired a vested right" "*based on the system then in effect*" and "on terms substantially equivalent to those then offered by the employer …." (*See, e.g., LA Fire, supra,* 210 Cal.App.3d 1095, 1102 (citations omitted) (emphasis in original)*; Pasadena Police, supra,* 147 Cal.App.3d at 703.)

As set forth in the Code, the retiree health plan is administered by the Retirement Board, which actuarially sets retiree health funding contributions. (Exh. 5302; Tr. 915-916, SJMC §§ 3.28.380, .385.) Employees contributed to the health plan based on the benefits in effect during their employment - the normal cost of such benefits over a ten-year period - and on an equal basis with the City. Similar to the pension plan, the retiree health plan is actuarially managed. (Tr.794.) Employees and the City have contributed to the Plan based on the assumption that they will receive the benefits currently in effect when they retire (*See, e.g.,* Exh.5412 (GURZA000634) (applying normal cost to retiree medical liabilities).)

With respect to the retiree health benefit, since 1984, the SJMC promised each individual member that he/she was "eligible to participate in a medical insurance plan sponsored by the city provided that the member satisfie[d] the following requirements:

> 1. The member retires for service or disability pursuant to the provisions of this chapter; and
> 2. The member applies for medical insurance coverage at the time of his or her retirement in accordance with the provisions of the medical insurance plan, and agrees to pay any applicable premiums.

(SJMC § 3.28.1970.) Pursuant to Section 3.28.1950 of the Code, a member could be "entitled to medical insurance coverage in an eligible medical plan, as specified in Section 3.28.1970, if the member satisfies the requirements of Subsection A., Subsection B., or Subsection C." In relevant part, subsection A of 3.28.1950 stated that a member qualified for retiree health benefits if he/she retired for service or disability and was "entitled to fifteen or more years of service."

These provisions unambiguously granted members a vested promise to retiree healthcare upon retiring for service or disability with fifteen years of service credit. Accordingly, those who took a job with the City after 1984 when the benefit was created under the Federated System relied on this promise of deferred compensation in accepting less pay than was offered in the private sector, staying in the City's employ, and formulating their retirement expectations and plans. (Tr. 106:24-28; 105:1-6, 15-27; 327:22-26.)

*ii. "Low Cost Plan"/ High Deductible Health Plan*

Measure B's revisions have permitted the city to adopt a High Deductible Health Plan ("HDHP") in contravention of members vested rights. In short, the HDHP resulted in a strident premium increases for retirees (Tr. 77) and lower obligations for the City. Axiomatically, cost savings associated with the HDHP are directly attributable to the higher premiums paid by retirees, which amount to $1,500 annually for an individual and $3,000 for family coverage (Tr. 644; 861-

62), compared to a $25 co-pay and no deductible prior to Measure B's passage (Exh. 373; Tr. 327:17-21; 328:25-28; 329:1)

There was some confusion on the City's part as to the relationship between Measure B and the HDHP. For example, Ms. Figone testified that the HDHP was attributable to Measure B (Tr. 605 ("the Court: Are they attributable or not? The Witness: They are attributable"), yet the following day she recanted (Tr. 619; *see also* Tr. 274 (attributing retiree health funding to Measure B).) In fact, the City's adoption of both the HDHP and elimination of SRBR were occasioned by the voter's passage of Measure B (Exh. 5109 (SJ003292) (indicating HDHP and SRBR adopted in June 2012 after passage of Measure B)), *i.e.* it was not until Measure B passed that the City established the HDHP as its lowest cost plan. (Tr. 621:13-28; 622:1-8.) Indeed, the circumstances under which the HDHP was adopted support the inference that the City views Measure B as permitting its adoption, especially in light of City Manager Debra Figone's memorandum to all City employees and retirees dated March 6, 2008 ("Figone Memo"), in which she indicated that 100% of the lowest cost plan ("LCP"), could be a vested benefit and the City would look at other ways to lower costs. (Exh. 361; Tr. 653:12-19.)

It is apparent that the change to the LCP was authorized by Section 1512-A(b), Measure B's anti-vesting provision, since members were vested in their right to retiree healthcare free of high deductibles or exorbitant costs. Although the City might argue that this section required an ordinance to implement and was therefore not effective, it is clear that the City believed that many of Measure B's provisions were self-implementing. (Tr. 945:21-28; 946:1-13 (Sections 1512-A(a) & (c) were self-implementing).) Section 1512-A(b) is one such purportedly self-executing provision.

For its part, Code section 3.28.1980(B)(1) always required the City to subsidize the cost of retiree health in an "amount equivalent to the lowest of the premiums for single or family medical insurance coverage, for which the member or survivor is eligible and in which the member or survivor enrolls under the provisions of this part, which is available to an employee of the city at such time as said premium is due and owing." According to this express contract, employees could expect that upon retirement, the City would cover the entirety of their retiree health premiums as long as they enrolled in the lowest cost plan available to active employees and in which they were enrolled. Pursuant to the language of the Code, the "lowest cost plan" was one which the retiree qualified for and enrolled, even if there was a lower cost plan available to active employees for which the retiree did not qualify.

Section 1512-A(c) of Measure B redefines "low cost plan" with respect to retiree healthcare benefits as "the medical plan which has the lowest monthly premium available to any active employee in either the Police and Fire Department Retirement Plan or the Federated City Employees'

Retirement System." In doing so, the City eliminated the requirement that the "lowest cost plan" be the one in which a particular retiree was actually eligible to enroll or the benefit the employee earned during employment. As a result of Measure B, the "lowest cost plan" may be one for which the retiree does not even qualify. Therefore, if the premium of the lowest cost plan available to actives is below that of the lowest cost plan in which the retiree is actually eligible to enroll, the retiree must pay the difference between the premiums. (See SJMC 3.28.1980(B)(2).) Given the fact that healthcare is more expensive for retirees than it is for active employees (*see generally, REAOC, supra, 52* Cal. 4th at 1171), AFSCME members can no longer expect a full subsidy of the cost of the premium for retiree health in the event that they enroll in the lowest cost plan for which they are eligible.

A further effect of Section 1512-A was to eliminate AFSCME members' vested rights to enrollment in a "lowest cost plan" lacking a high deductible or other exorbitant fee. Prior to Measure B, the City offered a stipend towards enrollment in the "Kaiser co-pay plan," which was the lowest cost plan for many years. (Tr. 810:17-23.) By eliminating that plan--which AFSCME members had enrolled in for years and expected to maintain during retirement (*see* Tr. 327:13-28; 328:1-8; 331:16-21, 334:17-26)--as the lowest cost plan and replacing it with the HDHP upon passage of Measure B, the City increased the cost of that plan to members. (*See* Tr. 809:3-7.) The Plan, by imposing a high deductible and a co-pay (Exh. 373; 328:25-28; 329:1; *see also* Tr. 689:23-28; 690:1-3 (referencing Exh. 525)), essentially shifts to the employee the premiums the City would otherwise be required to pay its insurance carrier for equivalent coverage. Therefore, it is an inaccuracy that the "cost" of the plan is lower, even though the premiums paid by the City may be.

System member testimony confirmed the fact that the HDHP hardly offered the low-cost healthcare employees were promised. Margaret Martinez, a recent retiree and Federated member, testified that she understood that if she worked for fifteen years, she would receive free healthcare upon retiring. (Tr. 327:22-28.) She enrolled in the Kaiser co-pay plan as an active employee, and before she retired, retirement services told her that the Kaiser co-pay plan continued to be the lowest cost plan. However, at her last meeting before retiring in 2013, she found out that the cost of the Kaiser plan went up to $318. (Tr. 327:12-21; 329:2-21.) Despite the fact, she stayed in the Kaiser co-pay plan in retirement rather than choosing the HDP because the HDP was extremely expensive and she was afraid of a costly unexpected injury that could lead to economic ruin (Tr. 328:9-28; 329:1; 336:1-14). While the Kaiser co-pay plan had no deductible (Tr. 861-62), the HDHP carries a significant deductible of around $1,500 and required payment of thirty percent of in-hospital care and $40 office visits that are not part of the deductible. It also requires payment towards many other

services that were free under the Kaiser plan. (Tr. 328:25-28; 329:1.) Therefore, she did not consider the HDP the "free" health plan she was promised she would receive in retirement. (Tr. 335:12-20, 23.)

Because the HDHP comes with a lower premium than the Kaiser plan, as a result of adopting a plan with a high employee-paid deductible, the City has now predicated its retiree health contribution rates on the HDHP insurance premium, even though few active employees elect it, as do even fewer retirees. (*See, e.g.,* Tr. 328:12-24.) The effect is that the City has drastically reduced the premiums it applies towards the retiree healthcare benefits that retirees and active employees enjoyed, while directly shifting the cost onto them through the high deductible. While retirees now shoulder a heavier burden of financing a retiree health benefit they were promised for free, the City saved approximately $7 million due to its adoption of the HDHP. (Tr. 642:20-28; 643:1-2; 693:5-13)

Whereas, in the past, the retiree health premium was based on a Non-Deductible HMO plan, it is now computed with respect to the HDHP. The unfairness of this arrangement is patent, especially in light of the fact that the City has told employee the retiree health benefit is "vested" and that the City will continue their benefits with no cost to them. This change in the nature of the benefits, applicable to current, vested employees and retirees, substantially undermines the retiree health benefit to which employees have contributed and that the City is obligated to provide.

Although the City asserted that 1512-A does not change anything that unions had not already agreed to, that is incorrect. In bargaining, unions had agreed to share a component of retiree health unfunded liabilities, which was renegotiated very recently. But no agreements require employees to pay more than half of retiree health UALs, nor have they in fact paid half -- or anywhere near half -- of the City's retiree health UALS. (Tr. 851; 1000-1001.) Nor are employees currently paying that amount. (Tr. 928; 1000-1001.) In addition, the union agreements were not open-ended requiring contributions in perpetuity; rather they were subject to continual negotiation under Government Code 5300, et seq. (MMBA). Finally, the agreements also contained an obligation on the part of the City to fund retiree health on an equal basis.

Because Federated members earned a vested right to the retiree health benefit permitted under SJMC sect. 3.28.1980(B)(2) upon retirement, Measure B unconstitutionally impairs that contractually-based expectation.

Even though neither clause contained language explicitly recognizing a vested right or specifying that the right would exist in perpetuity, it was nevertheless sufficient to create a vested right. Such is the case here, where the City clearly promised AFSCME members a right to receive retiree medical benefits upon meeting certain enumerated conditions.

*iii. "Unvesting" of Retiree Health Benefit*

In this case, the anti-vesting language of Section 1512-A(b) gives the City that very power to discontinue the benefit for those who paid its costs. Specifically, Measure B adds to the Municipal Code the following provision related to retiree health benefits: "No retiree health plan shall grant any vested right" and granting the City the right to "amend, change or terminate… [the] plan." (Section 1512-A(b).)

Prior to Measure B, the City specifically recognized the vested nature of retiree health benefits. For example, in the 2008 Figone Memo, Figone referred to the retiree health benefit as vested. She stated that, based on this fact, her office would not recommend changes to the benefit for retirees or active employees at the time. (Exh. 361.) In his cover letter transmitting the memo to retirees and beneficiaries, David Busse--the then-Chair of the Federated Board--stated that Ms. Figone's conclusion "should provide reassurance to" the recipient. (*Id.*) Employees understood the Figone Memo to be saying that retiree health benefits were vested and would not be changed. (*See* Tr. 327:5-10.) Additionally, in a memorandum dated May 27, 2008, former Human Resources Director Mark Danaj also told the City Council that retiree health benefits could be considered vested. (Exh. 441.) Such documents demonstrate that the City itself considered the benefits vested. (*See Sappington, supra,* 119 Cal.App.4th at 954-55; *see also REAOC, supra,* 52 Cal.4th at 1191 (courts may look to extrinsic evidence and the parties' course of conduct in determining whether rights vested).)

Other extrinsic and course of conduct evidence established that Federated members enjoyed a vested right to retiree health. For example, retirement handbooks, annual factsheets, and brochures distributed to City employees by its Retirement Services department reiterated facts such as: employees were eligible for retiree health after fifteen years of service upon service or disability retirement and that the City would cover the entirety of the premium for the lowest cost plan available to active employees and for which they were eligible. (*See, e.g.,* Exhs. 328, 330, 636, 653, 655, 706, 707 (handbooks); Exhs. 331-335, 337-342 (factsheets); Exhs. 343-344 (brochures).) Human Resources and other City agents reiterated these facts to new employees during their orientations. (*See* Tr. 103:25-28; 104:1-10, 22-28; 105: 1-11.)

The fact that AFSCME's MOUs are of limited duration does not change the result, because "[r]ights which accrued or vested under [an] agreement will, as a general rule, survive termination of the agreement." (*Litton Financial Printing Div. v. Litton Business Sys. Inc.* (1991) 501 U.S. 190, 207; *Thornton v. Victor Meat Co.* (168) 260 Cal.App.2d 452, 471; *see also Butchers' Union Local 229 v. Cudahy Packing Co.* (1967) 66 Cal.2d 925, 932.)

Whether by MOU or the SJMC, AFSCME members were explicitly granted retiree health benefits, which may not be unvested as Measure B purports to do.

*iv. Employees Have a Vested Right to Pay No More Than Fifty Percent of the Normal Cost of Retiree Health, and to a Matching Contribution by the City*

A substantial increase in an employee's contribution rate towards retirement benefits that is not explicitly permitted under the terms of the retirement system is an unconstitutional impairment of contract. (*Compare Allen, supra,* 45 Cal.2d at 131 (change not permitted by charter or city code) *with SD Firefighters, supra*, 34 Cal.3d at 300-302 (change permitted by charter and city code).)

Since 1984, the SJMC required members to contribute along with the City towards retiree health on a 1:1 ratio. (SJMC, § 3.28.385(c) ("Contributions for other medical benefits shall be made by the city and the members in the ratio of one-to-one.").)

Section 1512-A(a) of Measure B now impedes this contractual right by requiring that "[e]xisting … employees … contribute a *minimum* of 50% of the cost of retiree healthcare, including both normal cost and unfunded liabilities." (Emphasis added.) Therefore, Section 1512-A(a) is unconstitutional insofar as it requires its employees to finance more than half the cost of retiree health and eliminates the obligation of the City to pay a requisite amount. As discussed *infra*, the Code authorized just the Retirement Board to adjust contribution rates towards retiree health, and the City only specifically reserved its right to adjust funding ratios to comply with the requirements of 401(h) trust. (SJMC, § 3.28.1995.)

Section 1512-A(a) establishes a considerably greater funding obligation on the part of employees with no commensurate obligation on the part of the City (or an improvement in benefits). Whereas employees have contributed to retiree health on a 1:1 ratio (SJMC section 3.28.385), which necessarily obligates the City to also fund the benefit, Measure B section 1512-A(a) eliminates this obligation and funding limit. Instead, it adopts an open-ended requirement, applicable only to employees, to pay "a minimum of 50%" of both the plan's normal cost and its accrued unfunded liabilities. Currently, as discussed above, there are fewer active employees than retirees (0.83 actives to every retiree, which does not include deferred-vested members). Thus, Measure B imposes on employees not only the cost of their own, now unguaranteed benefits, but also the cost of a larger group of retirees who are also receiving the benefit. In these ways, Measure B unconstitutionally impairs employees' and retirees' vested benefits.

In essence, Section 1512-A of Measure B permits the City to shed its retiree health benefit obligation. According to Mr. Lowman, the City has been booking the full cost of retiree health, less the employee contributions. This results in the employees paying more than half the cost of retiree

health because the full ARC is not booked; only the ten-year funding projection is (even though employee contributions are based on the full ARC). (Tr. 251.) By un-vesting the benefit and eliminating the City's obligation to match employee contributions, Measure B permits the City to eliminate retiree health as a balance sheet liability.

*v. Measure B Impermissibly Requires Members to Pay Towards the Unfunded Liabilities Associated With Retiree Health*

Measure B imposes an obligation on active employees to contribute a "minimum" of 50% of the cost of the City's entire OPEB liabilities (Section 1512-A(a).) Prior to Measure B, such obligations were borne by the City. Also, because Measure B purports to "unvest" retiree health benefits, and eliminate any obligation to actually provide the benefits to retirees, it imposes on active employees the obligation to make payments to the City's Plan that quite possibly exceed the value of benefits they, themselves, will receive. Therefore, it imposes on employees the obligation to make contributions to the system's retiree health fund and does not distinguish between the unfunded liabilities attributable to active, deferred-vested or retired system members. (Tr. 270:4-16; 352:3-10; 499:26-28; 500:1-2; 511:8-23; 512:17-28; 513:1-3.) Rather, a reduced number of active employees--those who have remained in city service after layoffs, early retirements and wage cuts--are required to shoulder unfunded liabilities with respect to benefits obligations for System members who left employment with a vested pension and are now working elsewhere or who have retired. (*See id.*)

Recently, in *AFT Michigan*, a Michigan court of appeals described a similar arrangement as improper because "while the fund in question funds retiree health care benefits for present retirees, the active employees whose wages are taken have no vested right themselves to the receipt of health care benefits upon their own retirement." (*AFT Michigan, supra,* 297 Mich.App. at 605.)

In any event, the SJMC expressly placed upon the City the burden for financing unfunded liabilities associated with the retiree health plan, and Section 1512-A(a) is unconstitutional insofar as it impairs a member's vested right to not have to contribute towards these UAL. In *Wills*, a city began withholding money from its employee's paychecks to help finance its COLA-related unfunded liability attributable to retirees, "currently active past service members, and future service active members." (187 Cal.App.3d at 780, 784.) The city's municipal code placed on the city the responsibility for making "contributions for all amounts necessary to fund current and past service liability for all pensions and all other benefits allowable under the retirement system." (*Ibid.*) The court concluded that the city's "retirement system is one, actuarially based, integral system" and that "the COLA fund is merely a different part of a single overall pension plan." (*Id.* at 789.) That "reveale[d] an intention by the city to cover past unfunded liabilities not only for the pension system

but for the COLA system as well." (*Id.*at 789.) Notably, the court stated, "Although a COLA system was not in effect at the time these two sections were enacted, the city has manifested an express intent to cover past unfunded liability in the entire pension system." (*Ibid.*)

AFSCME's case is even stronger than *Wills* because the City incurred responsibility for financing all UALs with respect to retiree health. Here, the Federated pension and retiree health funds were also part of a single overall retirement plan known as the "Federated City Employees Retirement Plan" which included the provisions set forth in Chapters 3.16, 3.20, 3.24, and 3.28 of the Municipal Code. (SJMC § 3.28.010(B).) Chapter 3.28 included provisions related to pensions and retiree health.

Prior to Measure B, the City was required to finance the UALs for all benefits conferred under the plan, including OPEBs. SJMC sect. 3.28.850 required that the City make, after July 1, 1975, "current service contributions" to the system as a percentage of compensation earned. "Said percentage shall consist of the sum of two rates, the first being the one which is hereinafter referred to as 'city's regular current service rate of contribution,' and the second being the one which is hereinafter referred to as '*city's current service deficiency rate of contribution*.'" (*Id.* (emphasis added).) With respect to the City's current service deficiency rate of contribution, SJMC sect. 3.28.880 states that it:

> shall be such as may hereafter be necessary to make up, over a period of thirty years, any existing deficiency in the amounts of current service contributions theretofore contributed by members and by the city for the payment of the cost of ***all allowances and other benefits*** which are or will become payable to members on account of current service rendered before the effective date of the latest deficiency rate, such deficiency being that resulting from amendments hereafter made to this system ***or as a result of experience under this system.*** *Until the amount accumulated in the retirement fund from contributions of members and the city on account of current service equals the present value of all amounts thereafter payable from the retirement fund on account of current service, the city* ***shall*** *make monthly (or biweekly, if members contribute biweekly) contributions, to make up any deficiency,* ***at the current service deficiency rate established by the retirement board.*** Such rate shall be established and from time to time changed by the retirement board, whenever necessary, to accomplish the above-specified objective.

(Emphasis added.) Section 3.28.850 appears to require that the City solely finance the unfunded liabilities of the System for "all allowances and other benefits" attributed to "current service," or "all city service rendered by a member *after June 30, 1951*." (SJMC 3.24.1000(C) (emphasis added).)

It is clear that SJMC sect. 3.28.850 is not limited to pension benefit financing and that it also governs the City's obligations with respect to the UAL related to retiree health. Had the City intended to limit this section to the financing of pensions, it certainly would have done so. First,

Chapter 3.28 of the Code specifically distinguishes between "pension" and other benefits throughout. For example, SJMC sect. 3.28.900 states: "The City's prior service rate of contribution …. will be sufficient to pay, when due, all pensions, *allowances and other benefits* which are or will become payable under this system on account of prior service rendered prior to July 1, 1975." (Emphasis added.)

Furthermore, the Code also created a universal "retirement fund" called the "San José Federated City Employees Retirement Fund" ("SJCERF") into which contributions towards pensions and other retirement benefits were paid and out of which benefits were funded. (SJMC § 3.28.300.) Subsequently, the City specifically established the 401(h) retiree medical benefits sub-account within the pension trust. (SJMC § 3.28.380(A); *see also* Tr. 916:19-25 (retiree health contributions go into the Federated pension plan and are a part of the overall pension trust).) It even permitted the *co-mingling* of funds within the 401(h) "with other monies in the retirement fund solely for the purposes of investment." (*Ibid.*)

The City's trial testimony on this subject was consistent with the above. The City acknowledged that retiree health contributions go into the Federated pension plan and are a part of the overall pension trust, and it admitted that the retirement board administers the retiree health trust funds, and the trustees are fiduciaries. (Tr. 916:19-25; 917:6-9.)

Also, it is evident that the City treated its pension and OPEB obligations as one and the same. For example, the City's CAFRs for the Federated System included financial statements and analyses of both pension and OPEB health benefits. (*See generally,* Exh. 421.) Therefore, like in *Wills*, the pension and retiree health funds were part of the same overall retirement plan. As was the case in *Wills*, it is clear that the SJMC required the City, and not its members, to finance any OPEB UALs for service rendered after June 30, 1951.

Finally, in its brief in support of its Motion for Summary Adjudication, the City stated that, with respect to its failure to specify a specific contribution rate for retiree health unfunded liabilities, it "was simply not focused on the unfunded liabilities at the time of the legislation." (City's MSA, p. 32:6-7.) This is further proof that the parties never contemplated that City workers would pay towards retiree health UALs.

*vi. Measure B Impairs Members' Right to Have Contribution Rates Adjusted Exclusively by Retirement Board*

The SJMC, as incorporated into decades of MEF and CEO MOUs, provided that AFSCME members working after 1984 earned an express contractual right to having their retiree health contributions adjusted solely by the retirement Board. Therefore, upon commencing employment,

AFSCME members could reasonably expect to be held responsible for contributing towards fifty percent of the retiree health normal costs and that the board would retain exclusive authority to compel increased contributions towards those normal costs. Furthermore, they could reasonably expect the Board to only compel the City to increase contributions towards retiree health UALs. At all times pertinent to this litigation, prior to Measure B, the retirement board acted within its authority granted by the Code and only required that Federated members contribute towards the City's normal costs of retiree health on a one-to-one basis.

The Retirement Board is an entirely different entity than the City of San José. Pursuant to the state Constitution, "The retirement board of a public pension or *retirement system* shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries." (Cal. Const. art. XVI, § 17(a) (emphasis added).) As previously discussed, pension and retiree health benefits are provided under the same City retirement plan; as such, the PPA also applies with respect to the Board's authority over retiree health, and the Board is solely responsible for administering the retiree health plan. Therefore, neither the City nor its electorate may usurp that authority in contravention of its employees' reasonable retirement expectations. (*See Hudson v. Bd. of Administration* (1997) 59 Cal.App.4th 1310, 1330-1332; *OCDSA, supra,* 192 Cal.App.4th at 21.)

Consistent with these constitutional principles, the SJMC vested in the retirement *Board*, and not the City, the authority to adjust contribution rates related to retiree health and other benefits. (SJMC, §§ 3.28.200, 3.28.385 ("Contribution rates to fund the benefits for sickness, accident, hospitalization, dental or medical expenses shall be established by the board as determined by the board's actuary and shall be borne by the city and the members of the plan ….").) It also authorized the Board to adjust the City's contribution rates towards retiree health UAL. (See SJMC 3.28.880.) However, nowhere does it grant the City or the retirement board a right to compel contributions from its employees towards retiree health UAL.

Despite this, section 1512-A(a) of Measure B requires that active employees "contribute a minimum of 50% of the cost of retiree healthcare, including *both normal cost and unfunded liabilities*." (Emphasis added.) Because the electorate adjusted City employees' contribution rates and foisted upon them responsibility for financing retiree health UALs--despite the fact that only Board could do so -- Measure B further impairs the right to only have the retirement board affect contribution rates with respect to retiree health.

**e. The City's Anticipated Defenses**

i. Measure B is Not a "Reasonable Modification"

Measure B's provisions bear no material relation to the theory of a retirement system or its successful operation; they simply allow the City to escape from its obligation to provide its employees with these forms of deferred compensation with which it previously enticed them; furthermore, the charter amendment provides no comparable advantage. It is not enough to state that the pension system is underfunded, even severely so, to justify a reduction of vested rights. This has long been the case under California law. (*Abbott II, supra,* 165 Cal.App.2d at 519; *see also Pasadena Police, supra,* 147 Cal.App.3d at 704 n.3.) A modification is only reasonable if a commensurate benefit is provided to the particular disadvantaged employee. (*Wisley, supra,* 188 Cal.App.2d at 486 ("[t]he validity of attempted changes in vested pension rights depends upon the advantage or disadvantage to the individual employee whose rights are involved, and benefits to other employees cannot offset detriments imposed upon those whose pension rights have accrued." )

Simply, a fiscal desire on the part of a governmental agency to reduce the cost of the obligations it has undertaken does not justify impairment of a contract. This is especially so where the agency is responding with respect to its own affairs and contracts, as a "market participant," and not as a regulatory entity. Courts have repeatedly rejected such justifications for reducing pension and retirement benefits under the contracts clause. (*See Pasadena Police Officers, supra,* 147 Cal.App.3d at 704 n.3; *see also United States Trust Co. v. New Jersey* (1977) 431 U.S. 1; *Allen, supra,* 45 Cal.2d at 133; *Abbott II, supra,* 50 Cal.2d at 455; *Wisley, supra,* 188 Cal.App.2d at 487; *Frank, supra,* 56 Cal.App.3d at 246.)

In this case, the City recognized that Measure B, while serving as a vehicle to improve its own financial state, was not designed to preserve its retirement plans' financial solvency. (*See, e.g.,* Tr. 531:23-27; Exh. 701 (Measure B Section 1501-A discussing purported fiscal burdens of City's funding of retirement plans but making no findings that Measure B necessary to keep systems sound).) Furthermore, the City presented no evidence that it was on the verge of bankruptcy. It also admitted that, despite its concerns over its finances, it never declared a fiscal emergency because doing so was unnecessary. (Tr. 601:9-28; 602:1-8; 639:11-16.)

Although the City stated at trial that it was not pursuing a "fiscal emergency" justification to its Contracts Clause impairment (Tr. 1013:16-28; 1014:1-9), the bulk of its testimonial evidence related to the impact of the pension system on the City's budget. Although the City claimed poverty, the evidence does not support this claim. The City admits that "[d]espite the ongoing recovery of the

Silicon Valley economy, the City's revenue collections did not always keep pace due to the outdated structure of many of our revenues (Exh. 5108 (SJ001652).) In fact, the City has gone years without attempting to increase revenues, where it was recommended that it should. For example, its Structural Deficit Elimination Plan of 2008 contained multiple methods for increasing City revenues, none of which were pursued by the City. (Exh, 5100 (SJ001423).) However, during this period, many California cities increased revenues by passing various tax revenues (Exh. 495; Tr. 632.) Similarly, Ms. Figone's May 2, 2011 Fiscal Reform Memorandum similarly recommends various revenue-raising suggestions, including increasing the City's sales tax, which also went unheeded. (Exh. 5104 (SJ1581).)

The City presents retirement costs as growing at an alarming rate when expressed as a percentage of the City's budget, even in years 2013-2014 (See Exh. 5108, at SJ01651-52), Yet this comparison means is indicative only of the City's reduced total budget: Of course retirement costs, which are fixed, will appear larger when compared to a reduced City budget. More importantly, the method the City utilized to designate this obligation at trial relied on a market-value method for valuing plan assets, which does not treat the pension liability as actuarially-managed, amortized, or subject to smoothing (Tr.255; (The auditor's report is not an actuarial projection and does not apply actuarial principles, as required under the Plan); Tr. 539).)

The efforts of the City to portray pension obligations as unsustainable in the long-term fell flat. One example is its percentage-of-payroll comparisons, which is a comparison that provides more information about the City's reduced payroll than it does about its pension obligations. The City even decried the fact that payments for benefits from the plan exceed contributions into to the plan, yet that is to be expected because contributions are made with the expectation that investment income will also fund benefits (Tr. 306-09 (Lowman): "So your contribution has nothing to do with benefit payments. They're already funded. Obviously not 100 percent funded here. But in a mature plan that's 80 percent funded, you would normally find that the contribution coming in is less than the benefits going out…." (Tr. 309.)

Also, the fact that the pension system has a current funding deficiency is of no moment. As indicated by Chart A attached hereto, the SJFRS' funded ratio has gone up and down over the years, and a significant unfunded ratio was never considered a basis for curtailing promised benefits. Similarly, the City exaggerates its employee compensation in order to justify Measure B, using the City's UAL contributions as a component to compensation to suggest City employees are-over compensated. The truth is that, with respect to AFSCME, members earn on average a $66,000 salary (from which pension and health contributions are deducted) (Tr. 378 & Exh. 472). For fiscal year

2008, the average federated pension, for an employee that does not receive social security in a region that is one of the most expensive in the country, was a modest $34,500 (Tr. 503; 648). The City's efforts at trial to portray employee compensation and pensions as excessive was a contrivance, and undermined by the facts.

Although the City uses fiscal deficits dating back to 2003 to justify Measure B, in several of these years the pension plan was fully funded (Compare Ex. 6016 (page 6 of 6) with Chart A, attached hereto). In point of fact, during this period, in the early 2000s to the present, the City took on substantial debt unrelated to retirement benefits. (Exh 397, pp. 17, 80-81, 84; Tr. 674-75.) Its budget is constrained by the ensuing debt service, depriving it of revenues that could be used to fund services. Yet the City seeks to reduce it pension obligations in favor of increasing its bond offerings and servicing this bind-related debt, which dwarfs its pension obligations. (*Compare* Exh. 397, p. 88, *with* p. 103.) Prior to 2013, it did not attempt to renegotiate or refinance this debt, (Tr. 679) although it did so recently; this indicates that the City is far from insolvency. In essence, through Measure B the City has sought to reduce its obligations to retirees and employees rather than its other creditors.

Finally, for fiscal year 2013-14, the City is restoring services (Tr. 486-487). Ms. Figone agreed that, even before Measure B is implemented, the City has a budget surplus allowing improvement in city services and wages (Tr. 626-27), and the city has built up a "contingency reserve" of $29 million, as well as an economic incentive reserve and various other reserves. (Tr. 628-30.) Further, the City's 2012 CAFR indicates that the City's long-term liabilities *decreased* by a net $1.82 billion or 34.3 percent (Exh. 397, ( AFSCME001971)) and even this decrease includes an offset for newly incurred bonded debt as a result of "the issuance of 2011 Airport revenue bonds ($508.6 million) used to refund short-term commercial paper." (*Id.*) The 2012 CAFR also indicates that current and other liabilities decreased by $470.1 million, or 64.7 percent. The City's bond ratings are in the Aa1 and Aa+ range (Ex. 397, p. 16-17). Clearly, retirement benefits have not affected City solvency as a long-term prospect.

ii. The City's "Reservation of Rights" Argument

The City contends that employee retirement benefits may be reduced without violating the contracts clause because the Charter contains purported "reservation of rights clause" ("Clause"). The City's argument is that the retirement benefits "contract" cannot be breached if the provisions of the "contract" allow for its amendment. The argument fails as a matter of fact and law, and was more fully briefed on pages 14-25 of AFSCME's Opposition to the City's Motion for Summary Adjudication, which AFSCME incorporates by reference as though fully set forth herein. In any event, the Clause is inapplicable to retiree health and could not prevent the vesting of such benefits.

*aa. The Clause Did Not Prevent the Vesting of Any Benefits*

Factually, the charter provision does not *clearly and unequivocally* indicate to employees that their pension benefits are subject to diminution, as is required pursuant to *Bellus*, *England*, and other cases previously discussed. The legislative record, when properly construed, demonstrates that at the time of adoption, the various parties and constituents understood the provision to mean new plans could be adopted, but employees could not be pushed into a lesser term after having worked under a superior plan. As discussed above, at the time the provision was added to the Charter, California recognized a right to receive the pension benefit promised upon commencing employment, and so the Clause must be interpreted consistently with this constitutionally-derived rule.

1. Plain Language Does Not Support the City's Interpretation

The City argues that Section 1500 of the City Charter, authorizing it to "amend or otherwise change any retirement plan or plans" prevented the vesting of the benefits at issue in this case. However, a waiver of statutory or constitutional rights must be clear and unequivocal and specify exactly what is being waived, rather than being couched in general terms. (*See Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 352; *Requa v. Regents of the University of California* (2012) 213 Cal.App.4th 213, 231-32; *Pasadena Police Officers' Assoc. v. City of Pasadena* (1983) 147 Cal.App.3d 695, 703 n.3; *Alday v. Raytheon Co.* (9th Cir. 2012) 693 F.3d 772, 791 ("a reservation-of rights provision is effective only against contractual obligations explicitly covered by the reservation.") (citing cases).) Because the Clause does not do so, such language is legally insufficient to prevent vesting.

As more thoroughly discussed in AFSCME's Opposition to the City's Motion for Summary Adjudication ("MSA"), the word "amend" has a positive connotation. The Merriam-Webster Dictionary defined "Amend" to mean "to change or modify for the better**:** Improve." (*TM Patents, LLP v. I.B.M. Corp.* (S.D.N.Y. 2001) 136 F.Supp.2d 209, 217 fn. 6).) Therefore, the term "amend" does not authorize the diminution of retirement benefits or the terms under which they are offered. That the City has only ever improved benefits for Federated members supports this conclusion.

Furthermore, the broad phrase "otherwise change" lends no insight as to the extent of the City Council's powers to modify the retirement system for existing employees or to limit application of established constitutional principles. As discussed above, the court in *Legislature v. Eu* (1991) 54 Cal.3d 492, held that a more narrowly-tailored reservation of power clause did not prevent the vesting of rights to pension and retirement benefits. Therefore, it is clear that the Clause did not authorize a reduction of benefits in a manner that would prevent the vesting of the rights at issue in this case.

2. Case Law Does Not Support the City's Interpretation

Importantly, the California Supreme Court has already rejected the exact argument now raised by the City. The City relies on a single authority for its central defense to Measure B, *Walsh,* 4 Cal.App.4th 682, which considered changes to the Legislative Retirement Law ("LRL"), a retirement system "unique" among governmental pension systems. (*Id.* at 698.) During both Walsh's and Eu's service under the LRL, the State Constitution contained an "express reservation of rights clause" which permitted the limitation of benefits under the LRL. (Cal. Const Art. IV, sec. 4, par. 3.) However, this reservation of rights applied only with respect to Walsh, and not Eu's service. The courts reached different conclusions in each case by recognizing the factual and historical genesis of each, which the *Walsh* court summarized:

> The LRL does appear unique among California governmental pension plans. In this state governmental pension plans are typically funded by (1) the creation of an actuarially based retirement fund; (2) a provision for continuous appropriations or continuing obligations of the governmental entity; or (3) some combination of both," and yet, at the time Walsh served under the LRL "the Legislature did not create an actuarially based fund and did not provide for continuous appropriations for the payment of benefits. Instead, funding for the payment of benefits under the LRL was left to future year-to-year appropriations.

(4 Cal.App.4th at 698.) Thus, at that time the LRL was not a *pension system*, rather:

> The LRL, as it was enacted and during the period of Walsh's service, was unique in more ways than one. For one thing, the benefit and eligibility criteria of the LRL were under the direct control of the very persons who expected to receive benefits under it. For another thing, the LRL and its numerous amendments were enacted without any attempt to create an actuarially based fund or to provide continuing appropriations for its benefits, and thus the LRL was not subjected to comprehensive planning with respect to the benefits which would become payable and the source of funds to pay them. As a result the LRL was peculiarly susceptible to the possibility of conferring unwarranted windfall benefits to its members and of creating an unreasonable drain on the public fisc.

(4 Cal.App.4th at 702). However, "[i]n the mid-1970's the Legislature began to reform the LRL into an actuarially sound pension system. The legislative efforts in this regard included reducing benefits under the LRL to those consistent with a sound pension system, the creation of an actuarially based fund for the payment of future benefits, and, in 1977, the enactment of a continuing appropriation to support the payment[s]" all of which occurred "well after Walsh's service ended and cannot apply to him." (4 Cal.App.4th at 698 n. 5). In any event, The *Walsh* court directly addressed its holding in light of the earlier *Eu* decision (although Eu's service under the LRL was well after Walsh's):

> As we have previously noted, in 1977 the Legislature enacted a continuing appropriation in support of the LRL. We have no doubt that incumbent members of the Legislature at the time of the [enactment] had contractually vested pension rights under the LRL which would be protected under the contract clause. The question whether a former member of the Legislature acquired a contractual right to wholly

> unmodifiable pension benefits when he served during a time when the LRL was neither actuarially funded nor supported by a continuing appropriation, was not a question which was implicated in the *Legislature v. Eu* decision.

(4 Cal.App.4th at 700 n. 6 (citations omitted.))

The *Eu* court held that a "reservation of rights" clause did not prevent vesting of pension rights for incumbent legislators. It noted that the fact that the Constitution provided that "[t]he Legislature may, prior to their retirement, limit the retirement benefits payable to Members of the Legislature ...." neither stated nor implied that these rights are [] deemed inchoate and unprotected from impairment by the initiative process." (54 Cal.3d at 592.) Importantly, the Supreme Court noted: "*Significantly, we have never suggested that the mere existence of article IV, section 4, precludes legislators from acquiring pension rights protected by the state or federal contract clauses.*" (*Ibid.* at 529 (citing *Allen, supra,* 34 Cal.3d at 119-120) (emphasis added).) This conclusion in fact accords with *Allen*, which held:

> [N]ot only is the existing law read into contracts in order to fix their obligations, but the reservation of the essential attributes of continuing governmental power is also read into contracts as a postulate of the legal order. The contract clause and the principle of continuing governmental power are construed in harmony; although not permitting a construction which permits contract repudiation or destruction, the impairment provision does not prevent laws which restrict a party to the gains 'reasonably to be expected from the contract. Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change."

(34 Cal.3d at 120 (citations omitted).) Courts have since summarized the rule in *Allen*: "We must not overlook the qualifying rule, however, that the nature and extent of respondent's statutory obligation 'must be ascertained not only from the language of the pension provisions but also from the judicial construction of this or similar legislation at the time the contractual relationship was established.'"(*Newman,* 80 Cal.App.3d at 457-58 (quoting *Kern,* 29 Cal.2d at 850).)

To allow an exception to these doctrines, under a general, unspecific, reservation of rights clause, would damage these established constitutional principles, essentially allowing employees to embark on a contract, to labor under that contract, but have no ability to enforce that contract because of an alleged reserved power to amend. In other public contract contexts, such reservation of rights clauses are considered adhesion contracts and are rejected as a means of avoiding application of the contracts clause. (*See Blair v. Pitchess* (1971) 5 Cal.3d 258, 275-76; *Alameda County v. Ross* (1939) 32 Cal.App.2d 135, 144.)

///

///

///

*bb. Retirement System Material Did Not Affirm Retained Authority Over Benefits*

Even if it was unclear from the language of the Clause whether it permitted benefits reductions to a point that vested rights were defeated, extrinsic evidence originating from the City resolves any such ambiguity in favor of Plaintiffs. (*LaCount v. Henzel Phelps Constr. Co.* (1978) 79 Cal.App.3d 754, 770 (courts may consider extrinsic evidence in resolving any ambiguities in a writing and in determining how best to interpret the instrument); *see also Sappington, supra,* 119 Cal.App.4th 949, 953-54 (court considered extrinsic evidence and parties' course of conduct in determining meaning of policy in vested rights case).) Notably, such evidence describes to members their vested rights and includes no language indicating that the City could change benefit levels.

***1. Re Pension Benefit***

Retirement Services, a City agency, distributed retirement system newsletters intended for employees and retirees. (Tr. 920:19-28; 921:5-10.) Several of these newsletters demonstrate that the City did not believe it had authority to limit the pension benefit even in light of negative market performance. For example, an article entitled "Your Defined Benefit Plan and the Economy," told retirement system members:

> "[W]ith Defined Benefit Plans, such as the Federated City Employees' Retirement System …, the defined benefit is based on a formula that is not affected by market movements. Important factors in the formula are final average salary and years of service. That formula *does not change* based on how much money is invested in the retirement plan…. [W]hile there is inherent market risk in the retirement plan's investment, this risk is modified through the diversification of assets among a broad spectrum of investments. This market risk, however, does not impact the calculation or payment of an employee's retirement benefit."

(Exhibit 353, p. 1 (AFSCME001445) (emphasis added).)

Furthermore, another article published four years prior and entitled "Defined Benefit Plan and the Stock Market," specifically addressed plan participants' concerns that "the downturn in the stock market is going to affect their current or future retirement benefits." (Exhibit 351, p. 4 (AFSCME002710).) It conveyed the same exact understanding of the pension benefits available to retirees as was articulated in the article described above. The article concluded: "[I]t doesn't matter if the market goes up or down, your defined benefit is not affected."

Still, other newsletters include descriptions of the pension accrual rate and well as service and deferred-vested eligibility requirements consistent with the pre-VEP formula. (Exhibit 348, p. 2 (AFSCME002687 (benefit equals 2.5% times final compensation); Exhibit 349, p. 3 (AFSCME002694) (demonstrating pension benefits formula); Exhibit 513, p. 4 (AFSCME002706 (same); Exhibit 352, pp. 1, 4 (AFSCME001437-1440) (outlining service retirement and deferred

vested eligibility requirements).) Finally, a 1997 retirement services brochure covering service retirement described benefit eligibility requirement, the pension benefits formula, and specifically set forth the maximum benefit available. (Exhibit 343 ("Your benefit reaches 75% of final compensation at 30 years of service.").)

Notably, this material is lacks any language warning retirees that the City could decrease benefit levels based on any type of situation, including the market performance or its own financial condition. To the extent that City avers that the Clause contemplated creation of the VEP by blocking the vesting of rights to a particular contribution level, these publications demonstrate that the City did not believe that it possessed the authority to curtain benefit levels available to retirees.

***2. Re COLA and SRBR Benefits***

Another newsletter published shortly after the City extended the benefit of a flat three percent COLA to Federated System members demonstrated that the City intended to extend the benefit in perpetuity: "*Each year thereafter* on April 1, a flat 3% COLA adjustment *will be made* to those receiving the benefit on that date." (Exhibit 520, p. 1 (AFSCME001468) (emphasis added); *see also* Exhibit 521, p. 3 (AFSCME001474) ("Federated Retirement System provides COLA of a flat rate of 3% to all members who retired on or before March 31st of the year.)

Similarly, a newsletter article from 2003 entitled "SRBR Update" stated that the "[o]bjective of this new [SRBR] methodology is to create a program that will provide an *annual*, additional payment for retirees and to fix a minimum level of the SRBR to insure that the program can go down in perpetuity." (Exhibit 354, p. 1 (AFSCME001457) (emphasis added).)

The Court of Appeal previously held that such language of perpetuity was sufficient to create an express contractual obligation on part of a government entity. (*See Redding, supra,* 210 Cal.App.4th at 1122.) On occasion, the City has used durational language to limit a benefit enhancement to a finite number of times. (*See, e.g.,* Exhibit 349, p. 2 (AFSCME002693) (discussing SRBR and stating, "The June 2000 Federated retirement checks for many retirees and survivors will include a one-time increase in benefits amount.").) It did not place such a limitation of the aforementioned instances.

Furthermore, these articles--which did not refer to any authority to eliminate, suspend, or curtail the respective benefit-- also demonstrate that the City did not believe it had the authority under the Clause to negatively affect the benefits in the manner permitted by Measure B.

***3. Re Disability Retirement***

The newsletters also demonstrate that the City did not believe it had authority--pursuant to the Clause--to usurp the Board's authority to consider and grant disability retirement. In an article from

September 2002 entitled "The City of San Jose Disability Retirement Process," the City described the process without mentioning its right to take over the process at any time. (Exhibit 351, p. 2 (AFSCME002708) ("The Retirement Board makes the determination as to whether the employee is granted a disability retirement.").)

Furthermore, a 1998 retirement services brochure on the subject of disability retirement summarized the disability retirement process, the definition/qualifications for disability retirement, and the benefit formula. (Exhibit 344.) The information presented within the brochure comported to the pre-Measure B parameters, and the brochures did not contain any sort of disclaimer setting forth the City's authority to change the formulas set forth within.

***4. Re Survivorship Benefits***

Furthermore, a 1998 retirement services brochure on the subject of disability retirement summarized the disability retirement process, the definition/qualifications for disability retirement, and the benefit formula. (Exhibit 372.) The information presented within the brochure comported to the pre-Measure B parameters, and the brochures did not contain any sort of disclaimer setting forth the City's authority to change the formulas set forth within.

***5. Retirement Handbooks, Benefits Fact Sheets, and Summaries of Principle Provisions Show City Did Not Believe it Retained Authority Retirement System Newsletters***

Just like the retirement system newsletters described above, the Federated City Employees Retirement System Handbooks were intended to summarize to members their retirement benefits available under the SJMC. (*See, e.g.,* Exhibit 328, p. 1 (AFSCME001226).) These handbooks contained information outlining retirement contribution levels, vesting, service and disability retirement and the computation of benefits, the COLA, retiree health and dental benefits, survivorship benefits, etc. (Exhibits 328, 330, 636, 653, 655, 706 & 707.) However, they did not contain language stating that the City had the authority to limit such benefits pursuant to the Clause.

Similarly, decades of benefits fact sheets annually distributed to System members provided them with comprehensive information regarding retirement, including contribution rates attributable to both active employees and the City as well as eligibility requirements and the benefit itself. (Exhibits 331-342.) These fact sheets regularly displayed the contribution rates and benefits calculations set forth by the pre-Measure B Charter and Municipal Code but did not express a reservation of authority.

Finally, various documents entitled "Summary of the Principal Provisions of the Federated City Employees' Retirement System" attached to retirement system annual reports described

Federated System benefits and contributions consistent with the pre-Measure B Municipal Code. (Exhibits 367-369; 411; 412, pp.5-6 (AFSCME004578-79).) However, like the aforementioned documents, these also did not contain a caveat expressing the City's authority to diminish any part of the benefit.

*cc. In Any Event, the Clause Does Not Apply to Retiree Health Benefits*

Article XV of the City's Charter governs the City's retirement systems includes Sections 1500 and 1503, which respectively address the City's duty to provide retirement systems and to continue existing retirement systems. These sections, which include language the City believes constitutes the reservation of power, must be construed in harmony with the remaining provisions in Article XV. For example, Sections 1505(a) and (b), which respectively address minimum service and disability retirement requirements, apply exclusively to traditional pension benefits. Additionally, the current service contribution rates set forth in Section 1505(c) of the Charter are inconsistent with those established for the retiree health program. Furthermore, when the Charter was adopted in 1965, there was no retiree health program in place. (Exh. 5101, p. 14 (AFSCME000024).) Therefore, in adopting the 1965 Charter, it appears as though the voters were concerned with traditional pension benefits, did not contemplate retiree health benefits, and did not intend for the aforementioned Clause to apply to a future retiree health benefit. In fact, up until this litigation, the City never asserted its supposed right to amend retiree health benefits pursuant to these charter provisions.

Further evidence of the fact that the clauses did not apply to retiree health is the fact the SJMC specifically reserves to the City only the right to adjust retiree medical and dental funding ratios to comply with the requirements of the retiree health section 401(h) account. (SJMC §§ 3.28.1995, 3.28.2045.) If the clauses within the Charter did, in fact, apply to retiree health, than these Code provisions would be unnecessary. Furthermore, the fact that the City specifically reserved its rights with respect to these provisions and not others further demonstrates that it has no such reservation of rights with respect to other aspects of retiree health.

*iii. "Course of Conduct" / Past Negotiation of Pension and OPEB*

AFSCME anticipates the City to contend that the pension benefits and UAL contribution requirements could not vest because they are subject to negotiation under the Meyers-Milias-Brown Act ("MMBA") and that in the past the unions have negotiated increased pension contributions. With respect to AFSCME, this is factually incorrect: AFSCME has never proposed or agreed to a reduction of benefits or increased pension contributions with respect to active employees. (Tr.

379.16-22.) There is nothing in the record to contradict this fact. (Tr. 743:9-25; 922:26-28; 923; 924:1-4.)

The City's argument is not only an unprecedented and remarkable extension of the reach of the MMBA, but it is legally incorrect. In essence, the City argues that because Gov. Code section 3505.7 provides that a public employer may "impose" changes to the terms and conditions of employment after exhausting its duty to bargain in good faith, and because retirement benefits are a term and condition of employment subject to bargaining, the City may change pension benefits however it likes (provided it has exhausted its duty to bargain).

First, California's vesting doctrine is constitutionally derived, whereas the MMBA is a legislative enactment subject to the authority of the Legislature. Unions may not negotiate away their members' vested constitutional rights. (*See Fontana, supra,* 67 Cal.App.4th at 1255; *Phillips v. State Pers. Bd.* (1986) 184 Cal.App.3d 651, 660, *disapproved on other grounds in Coleman v. Dep't of Pers. Admin* (1991) 52 Cal.3d 1102, 1123, n.8); *see also Soc. Servs. Union v. Bd. of Supervisors* (1990) 222 Cal.App.3d 279, 287.)

Secondly, the Legislature cannot pass laws that impair Constitutional protections. California's vested rights doctrine with respect to retirement benefits was recognized well before public employees were accorded the right to collectively bargain by the legislature when it passed the MMBA in 1968. (*See, e.g., Allen, supra,* 45 Cal.2d at 128 (decided in 1955).)

Simply, the requirement to bargain over terms and conditions of employment has only ever been subservient to the Constitution, its guarantees and protections. While no union can bargain away vested rights, the converse is not true: vested rights can be established as a result of the bargaining process. (*REAOC, supra,* 52 Cal.4th at 1179.) But that is not the *only* way they can arise, and no contractually-protected rights can be eliminated or reduced through bargaining, as that is beyond the power of either the employer or the union.

iv. *Argument Regarding Plenary Power Over Compensation*

The City contends that its authority over matters of employee compensation permit it to make adjustments to compensation for the purpose of shoring-up its unfunded liabilities. In doing so, the City has relied on cases permitting adjustments to employee contributions. In all such cases, however, adjustments have comported to the theory of the particular pension system - that is an independent actuarial valuation has permitted adjustments to normal cost contributions.

The Federated System includes a method for adjusting normal cost contributions in relation to the plan's actuarial experience. These adjustments have only ever been made on a going-forward

basis. Courts have rejected the City's contention that its authority to set compensation allows it to adjust the means of pension funding on a prospective basis, specifically in *Eu* the Court noted:

> Petitioners and respondent PERS contend, however, that pension rights fall into a different category than salary rights. Although a state officer may have no protectable right to continuation of his former salary from term to term, nonetheless on commencing to serve the state the officer thereupon acquires a vested right to earn, through continued service, additional pension benefits in an amount reasonably comparable to those available when he or she first took office. According to petitioners, that right is not extinguished when one term of office ends and another commences. To hold otherwise, petitioners argue, could unduly penalize public officers who serve elective or appointive terms. We agree with petitioners.

(54 Cal.3d at 530-31 (internal citation omitted).) As described in *Allen*, a dynamic between pension and salary exists:

> In so defining such [pension] allowances, the LRL thus contemplated retirement benefits which would vary with current legislative salaries, presumably in order that retirees, like current legislators, could maintain a fairly constant standard of living despite fluctuations in living costs. Implicit in this scheme was the assumption that legislators' salaries periodically would be adjusted to reflect current costs of living.

(34 Cal.3d at 117).

To avoid application of this precedent, the City has sought to characterize pension contributions and wages as interchangeable. However, AFSCME has never negotiated increased pension contribution rates for its members, and never treated the two as interchangeable. (Tr. 379-80). The City presented no evidence that contradicts this factual conclusion; indeed the City conceded it. In any event, good reasons exists for AFSCME's policy and practice regarding pension contributions. (Tr. 380.) Moreover, AFSCME's MOUs refer to pension contributions and have consistently provided that "retirement contributions will be deducted as a percentage of salary earned and that service credit will be defined in the applicable … Code." (*See, e.g.,* Exh. 302 (section 31.7.1).) Clearly, therefore, MOUs have treated pension contributions as distinct from salary.

Although recently, and in anticipation of trial, the City has begun to define "total compensation" to include a *pro rata* portion of the City's entire UAL obligations, this accounting maneuver makes little sense with respect to compensation as the obligation bears no relation to compensation. This designation requires considering UAL obligations attributable to retirees to be compensation for current employees (Tr. 924). As Labor Economist Doonan stated, "For pay setting purposes, it doesn't make much sense to include essentially legacy costs [UAL] as a benefit to a worker." (Tr. 363.) By way of example, Mr. Doonan explained, "So if you are setting pay, if you were paying 10 percent of payroll to 50[%] for the retiree benefits, it's not really going to benefit the next person you hire." (Tr. 363.) Mr. Lowman, enrolled actuary, also explained the difference

between the City's normal cost contributions and its UAL contributions. He stated with respect to the City's 80% of salary pension contributions: "[W]e're not talking about the normal cost here, we're talking about legacy cost, yet we're contributing to a percent of payroll for active employees, even though we're talking about some of this cost really being for former employees." (Tr.270). The City Auditor also confirmed this fact (Tr. 490-91.)

To be clear, although Mr. Gurza testified generally regarding unions' past negotiating of increased pension rates (*see, e.g.,* Tr. 733), he admitted that none of that testimony applied to AFSCME (Tr. 743). Indeed, Mr. Gurza and Dr. Allen each verified that the City had requested AFSCME to join in bargaining over additional pension contributions, but AFSCME declined to do so, having a closed and integrated MOU (Tr. 743; 923; 924 (Mr. Gurza noting AFSCME was not a part of any agreement to increase employee pension contributions).)

Although the City may now contend that it treats employee compensation as including pension legacy costs in the form of system UALs, historically it has not done so. For example in 2010-2011 bargaining, the City Council directed its labor relations department to seek a "10% reduction in total compensation" from city employee unions (Exh. 5106, at SJ001642-43). The City Achieved this with respect to non-safety groups, including by imposition on AFSCME. Notably, this reduction in "total compensation" did not include a reduction associated with the City's UAL payments (*Id*.) In other words, the City's own bargaining position has not historically treated payment of UALs as a component of "total compensation." (*See also* Exh. 5117, (SJ003769).) Similarly, the City's own "Fiscal Reform Plan" indicated that a 10% of total compensation had been achieved in these negotiations, even the reduction in "total compensation" did not include any payments of UALs by employees (Ex. 5109, at SJ003298). Yet by reducing payroll by $83 million, the City reduced its normal cost contribution by 11 to 13 percent (Tr. 364). Now, at trial, pegging employee compensation to UALs obligations in light of this past history is a contradictory position for the City to take. As explained by Mr. Doonan: the "City wants it both ways in this case. The pay cuts were already implemented to pay for the increased cost of retirement benefits, and at this point, the City is coming back asking for higher contributions as well" (Tr. 364.) In other words, if the City treated the pay cuts as equivalent to contributions to the plan, then the City's argument about interchangeability of wages and pension might make some sense, but they are not (Tr. 364.)

Actuarially speaking, compensation changes have an effect on pension plan funding, but this does not make them "interchangeable." Because lower pay results in lower pension liabilities (assuming final compensation is resultantly lower for purposes of calculating the pension annuity (Tr. 235-36)), the positive actuarial effect is pronounced in plans, such as the Federated System, that use

an entry-age normal method because employees have been pre-paying into the plan based on prior expectations of their final salary levels (Tr.238-39). The Federated System's 2012 valuation reflects this fact: "The actuarial gains in 2010 and 2011 are primarily due to actual salaries being less than expected." (Exh. 416, at AFSCME003458). Similarly, salary increases bargained by unions have an actuarial effect on plan liabilities to the extent they exceed the plan's actuarial assumptions, which is why the actuarial assumptions are frequently reviewed and revised in order to account for such increases. In this way, salary increases are "paid for" by employees in their entry-age normal cost contributions. This means that compensation and contributions are far from interchangeable, they are separately accounted for, separately bargained, and have differing effects on plan funding. For good reason AFSCME has not treated them as interchangeable.

*v. Prior Benefit Enhancements, If Any, Do Not Justify Measure B*

aa. Benefit Enhancements Have No Bearing on Legal Question and Were Legitimately Achieved

The City might argue that the impairments caused by Measure B were justified because it provided Federated members with benefit enhancements which resulted in financial hardship to it. Again, this is a red-herring argument because it has no bearing on the legal question before the Court. However, even if pertinent, such a contention is without merit.

Any benefits enhancements enjoyed by AFSCME members and retirees were the result of good-faith bargaining between the City and its collective bargaining units and were designed "to provide benefits similar to those made by other California local governments which followed benefit enhancements awarded at the state level during the dot-com boom." (Exh. 5101, p. 12 (Gurza000022).) Therefore, such enhancements resulted from legitimate mutual agreements between the City and its unions. The fact that they were on par with other public agencies dismantles the notion that they were somehow excessive.

Once granted, these enhancements became constitutionally protected vested rights, and the City was required to fund them. (*Betts, supra,* 21 Cal.3d at 530; *Bellus, supra,* 69 Cal.2d at 336.) As a result of agreeing to fund these benefits, the City assumed responsibility for any unfunded liabilities that result from them. (Exh. 5101, p. ii (Gurza000004); SJMC, § 3.28.710; *see also Bellus, supra,* 69 Cal.2d at 336.) Therefore, even if such benefits were costlier than the City originally predicted, it still had to fund them.

///

///

bb. Fixed COLA Was Not a Benefit Enhancement and Did Not Increase City's Costs

The last benefit AFSCME successfully bargained-for was the guaranteed three percent COLA benefit. However, the evidence demonstrates that the conversion in 2006 to the fixed COLA did not result in an actual enhancement because the previous COLA regime also provided a three percent annual cost of living adjustment.

Prior to 2006, the COLA benefit had a "banked feature" by which the annual COLA equaled "the increase in the Consumer Price Index ("CPI"), up to 3%." (Exh. 444.) The CPI attempts to quantify the cost of living. "If the CPI gr[ew] by more than 3%, the portion in excess of 3% [wa]s 'banked' and [wa]s applied in years when the CPI gr[ew] less than 3%." (*Id.*)[7] A review of various Board resolutions reveals that this is exactly what happened during that time. For example, in:

- 1988, the CPI was five (5) percent, but a three (3) percent COLA distribution was authorized and the remainder was banked (Exh. 325)
- 1987, the CPI was 2.1%, but a three (3) percent COLA distribution was authorized (Exh. 326);
- 1991, the CPI was six (6) percent, but a three (3) percent COLA distribution was authorized and the remainder was banked (Exh. 324);

(*See also* Exh. 399, p. 23 (AFSCME002853) (showing 10 year inflation average for the 1980s at 5.4%).)

In that time, employees were contributing to the normal cost of the COLA benefit based upon the assumption that it would equal three percent in a given year. (Tr. 12-24.) Similarly, plan actuaries were assuming a three percent COLA payout. (*Ibid.*)

In fact, when the City adopted the flat three percent COLA in 2006, it indicated that the change would result in a minimal impact on the System's UAALs and actuarially calculated contribution rates. (Exhibit 444.) This was a correct prediction, since in the years following the changed COLA policy in 2006, the City's contribution rate did not change as a result of the formula adjustment. (*See* Exh. 421, p. 101 (2012 Federated CAFR).) Although the City argues that the fixing of the COLA caused the City financial harm, Erickson admitted at trial that the City had no idea what percentage of the rise in the Federated plan's UALs was due to the change from the banked to fixed COLA. (Tr. 512:11-15.) Therefore, there is no evidence that the changing of the COLA caused the City any sort of financial detriment or constituted an "exorbitant enhancement."

[7] "For example, if the CPI increase[d] by 5%, retirees receive[d] a 3% COLA and 2% [wa]s 'banked' to be used in years when the CPI [wa]s less than 3%." (Exh. 444.)

*vii. Ordinances Do Not Save Measure B*

Any contention that implementing ordinances require the City consistently with state law must be rejected because AFSCME's challenge to Measure B is a facial one, and such a challenge "considers only the text of the measure itself…." (*Tobe v. City of Santa Monica* (1995) 9 Cal.4th 1069, 1084.) Therefore, said ordinances are irrelevant to the issues in this case.

However, even if the ordinances were somehow pertinent to this case, they are functionally null and void if they conflict with the post-Measure B charter. (*Domar Electric, Inc. v. City of Los Angeles* (1994) 9 Cal.4th 161, 170.) For example, ordinances requiring the Board to apply Section 1513-A consistently with the PPA are null because they conflict with Measure B, as show *infra*.

**B. Taking of Private Property Without Just Compensation or Due Process**

A public entity may not take private property for public use in the absence of just compensation. (Cal. Const. art I § 19.) Nor may a public entity pass regulations having the effect of depriving individuals of their property, as did the City through Measure B. Further, California's Constitution, Article I, section 7, provides "A person may not be deprived of … property without due process of law." Measure B also constitutes an unconstitutional takings and violates employees' rights to substantive due process guaranteed by the California Constitution by taking their vested property rights without affording them a comparable advantage or commensurate benefit or compensation.

As previously discussed, Measure B negatively effects employees' salaries and retirement benefits. Public employee salaries are constitutionally protected property rights. (*Sims v. United States* (1959) 359 U.S. 108, 110 ("it is quite clear, generally, that accrued salaries are property."); *Ng. v. State Personnel Bd.* (1977) 68 Cal.App.3d 600, 606).) Also, retirement benefits are considered deferred compensation. (*Terry v. City of Berkeley* (1953), 41 Cal.2d 698, 703; *see Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1071 ("Recognizing that retirement benefits are just a deferred form of employment compensation, the appellate court disagreed with the trial court's conclusion that under [Gov. Code] section 1091.5(a)(9) pensions were not salary."); *Willens v. Commission On Judicial Qualifications* (1973) 10 Cal.3d 451, 456 fn.6 ("Several cases have held that retirement or pension benefits are a form of deferred compensation or "salary" paid to an employee in consideration for his services."); *LA Fire, supra,* 210 Cal.App.3d at 1102-1103.) California courts have long considered deferred compensation, including pension benefits, as representing a property interest. (*In re Marriage of Brown* (1976) 15 Cal.3d 838, 842 ("Pension rights, whether or not vested, represent a property interest; to the extent that such rights derive from employment during coverture, they comprise a community asset subject to division in a dissolution proceeding."); *In re Marriage of*

*Sommers* (1975) 53 Cal.App.3d 509, 515 ("Deferred compensation, accrued pensions, annuities to take place in the future, and social security, veterans' and insurance benefits are well recognized property rights and are properly the concern of courts upon the severance of the marital relationship.").) Similarly, federal courts consider retirement benefits as constitutionally protected property rights. (*See Portman v. County of Santa Clara* (1993) 995 F.2d 898, 906 ("[T]he Ninth Circuit and other courts have held that the deprivation of *pension* or *disability* benefits amounts to the deprivation of constitutionally protected property.").)

Courts have held that a legislature may not transfer funds from one retirement system to another, as doing so violates the due process clause. (*See, e.g. Association of State Prosecutors v. Milwaukee County* (1996) 199 Wis.2d 549, 564 [544 N.W.2d 888, 894] ("we hold that vested employees and retirees have protectable property interests in their retirement trust funds which the legislature cannot simply confiscate… we conclude that the transfer of funds from the County Plan to the State Plan … takes property without due process of law"); *People ex rel. Sklodowski v. State* (1994) 162 Ill.2d 117, 151 [642 N.E.2d 1180, 1194] (Transfer of pension funds "substantially impaired pension benefits."); *Sgaglione v. Levitt* (1975) 37 N.Y.2d 507, 512 [337 N.E.2d 592, 594-5] ("Although not essential to this conclusion is the salient fact that the reserve funds contain sums at some time paid regularly or specially by contributing employees. These employee-contributed funds, therefore, are not any longer State or municipal funds raised solely by the tax-levying power.").)

With respect to the federal and Michigan Takings Clauses, the court in *AFT Michigan* stated:

> The law is … equally clear that where the government does not merely impose an assessment or require payment of an amount of money without consideration, but instead asserts ownership of a specific and identifiable "parcel" of money, it does implicate the Takings Clause. Indeed, the United States Supreme Court has termed such actions violations 'per se' of the Takings Clause.

(297 Mich.App at 618 (holding that withholding of additional monies for state workers to fund retiree health constituted unconstitutional impairment of contract, taking and violation of due process).)

Where Measure B seeks to impose excises on employees to pay for the benefits of others, or to offset the system's UALs which otherwise are a general obligation of the City, it constitutes a transfer of funds, and liabilities, in violation of the takings clause. Similarly the liquidation of the SRBR constitutes a taking without just compensation.

**1. "Unvesting" of Benefits**

Measure B inserts language that purports to eliminate vesting of retirement benefits. (Section 1512-A(b); *see also* Sections 1504-A, 1505-A.) To 'vest' means "'[t]o confer ownership (of property) upon a person' and '[t]o invest (a person) with the full title to property.' (BLACK'S LAW

DICTIONARY (9th ed. 2009).)" (*In re Jones* (9th Cir. 2011) 657 F.3d 921, 928; *see also Poore v. Simpson Paper Co*. (9th Cir. 2009) 566 F.3d 922, 926 ("vested means permanently fixed and unalterable.").) Property cannot be taken without due process or just compensation under the Constitution, and therefore to the extent Measure B seeks to "unvest" any employees' or retirees' vested rights without compensation or due process, it constitutes an unconstitutional taking.

Finally, where the pension system operates as an alternative to social security, federal law requires the benefits may not be subject to alienation once accrued. Measure B's "unvesting" language conflicts with federal and state law.

**2. Wage Excises**

As stated in *AFT Michigan*, involving a 3% wage excise for retiree health funding:

> Clearly, the government has "taken" three percent of plaintiff employees' wages in the dictionary-definition sense of the word. The state does not dispute that the school districts are taking possession of wages that, by contract, belong to plaintiff employees and are sending them to state-mandated funds as employer contributions. The question, however, is whether this action constitutes a "taking" as it has been defined for purposes of the Fifth Amendment and its Michigan constitutional counterpart. We conclude that it does.

(297 Mich.App. at 617.)

The *AFT Michigan* court also noted that the defendant State sought "to blur the issue by repeatedly arguing in their briefs that it is only fair for those who receive a health care benefit to help pay for it. This principle, however, is as irrelevant as it is self-evident" because "the statute does not provide that the monies obtained by the involuntary collection of three percent of the workers' wages will be used to fund the retiree health care benefits of those whose wages are being taken." (*AFT Michigan, supra,* 297 Mich.App. at 607-08). Importantly, the court noted:

> We cannot envision a court approving as constitutional a statute that requires certain individuals to turn a portion of their wages over to the government in return for a "promise" that the government will return the monies, with interest, in 20 years when the government retains the unilateral right to "cancel" the "promise" at any time and does not even agree that, if they do so, the monies taken will be returned. School employees cannot constitutionally be required to "loan" money to their employer school districts, with no enforceable right to receive anything in ex-change and without even a binding guarantee that the "loan" will be repaid.

(*Id.* at 608).

**3. Hobson's Choice VEP Plan**

Measure B seeks to require employees to forego their vested pension rights or suffer an up to a sixteen percent wage reduction. Here, no due process or just compensation is provided; rather, the City seeks to force relinquishment of constitutional rights by imposing a wage deduction on those who do not agree to do so.

#### 4. "Poison Pill" Provision Requiring Wage Excise In Event of Successful Legal Challenge

For the same reason the VEP wage excise constitutes a taking. Section 1514-A of Measure B, which requires compensation reductions in the event that portion of Measure B is struck down, also constitutes a taking without due process.

### C. Pension Protection Act ("PPA")

The California Constitution gives public sector retirement systems the "sole and exclusive fiduciary responsibility" over the system's assets and its administration. (Cal. Const. art. XVI §§ 17, 17(a).) It also requires system assets be held in "trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries…." (Cal. Const. art. XVI § 17(a).) It further provides that "the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system…" subject to specified conditions. (Cal. Const. art XVI § 17). Also, the Retirement Board "shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system[,]" and "it shall also have the sole and exclusive responsibility to administer the [S]ystem in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries." (*Id.*) Finally, the "assets of [the System] are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the [System] and their beneficiaries and defraying reasonable expenses of administering the [S]ystem." (*Id.*; *see also* Tr. 893:1-16 (City recognized that employee and City pension contributions--whether derived from contracts, the MuniCode, or "other document"--transmitted to retirement funds and intended to fund benefits).)

A Retirement Board's "duty to its participants and their beneficiaries shall take precedence over any other duty." (Cal. Const. art XVI § 17(b).) The Board has the "exclusive fiduciary responsibilit[y] … to provide for actuarial services in order to assure the competency of the assets of the" System. (Cal. Const. art XVI § 17(e); *see also* SJMC § 3.28.350(B).)

The PPA prohibits a public agency or employer from usurping the authority vested in a retirement board of a public retirement system. (*See Hudson v. Bd. of Administration*, 59 Cal.App.4th at 1331-32). Here, the City's Municipal Code has recognized the obligations imposed by the PPA. Namely, the SJMC grants the Retirement Board exclusive control over investing and administering of the retirement fund assets. (SJMC § 3.28.310), and indicates such assets are "held for the exclusive purposes of providing benefits to members of the plan and their beneficiaries and defraying

reasonable expenses of administering the plan." (SJMC § 3.28.350(A).) Specifically, SJMC Section 3.28.350(B) commands:

> *The board shall discharge its duties with respect to the plan solely in the interest of, and for the exclusive purposes of providing benefits to, members of the plan and their beneficiaries, maintaining the actuarial soundness of the plan in a manner consistent with Article XVI, Section 17 of the California Constitution* (the "1992 California Pension Protection Act"), and defraying reasonable expenses of administering the plan. *The board's duty to the members and their beneficiaries shall take precedence over any other duty.*

(Emphasis added.) Several of Measure B's provisions are inconsistent with these mandates and usurp the Board's exclusive authority over its retirement System in violation of the PPA.

**1. Assertion of Discretion Over COLA**

Pursuant to the Municipal Code, the COLA is a benefit enhancement to the City's pension allowance. (*See* SJMC § 3.44.160(A)(1).) For this reason the Board -- and not the City -- had sole and exclusive fiduciary responsible over administering and investing the COLA funds for the benefit of participants. As such, not only was the City without power to decrease employees' COLA benefits, but Measure B also contravened the PPA's command that the pension assets be used for the benefit of its employees.

The Municipal Code itself is further evidence of the Board's exclusive authority of the COLA funds. Because the COLA is subject to the same Code provisions as the pension benefit, the Board exercises exclusive control over investing and administering the COLA funds within the Federated System and holds the assets for the exclusive purpose of providing benefits to the System's beneficiaries. (SJMC §§ 3.28.310, 3.28.350(A).) Pursuant to the specific COLA provisions within the City Code, the Board was exclusively permitted to, amongst other things, adjust members' COLA contribution rate and invest COLA monies (SJMC § 3.44.100(B)(1), B(2), 3.44.140(B).)

**2. Liquidation of SRBR Fund**

Established principles of trust law, contained in the Constitution and the SJMC, prohibit eliminating and raiding the assets of the SRBR. The SRBR trust fund was created for the benefit of Federated retirees. The SJMC specifies that it "shall be used only for the benefit of retired members, survivors of members, and survivors of retired members." (SJMC § 3.28.340(E)(1); *see also* SJMC § 3.28.340(E)(2).) This mandate accords with section 17(a) of the PPA which requires that the "assets of a public pension or retirement system … shall be held for the exclusive purposes of providing benefits to participants…." (*See also Keitel, supra,* 103 Cal.App.4th at 337 (discussing elements of express trust); *Palm Springs, supra,* 70 Cal.App.4th at 619 ("The legal title of the res or corpus of any trust is held by the trustee, but the beneficiaries own the equitable estate or beneficial interest").)

Although the City realized around $13 million in savings from eliminating the SRBR, as previously discussed, City employees received no benefit. (Tr. 936:22-23, 28; 937:1, 16-21.) By eliminating the trust and diverting the corpus to offset the City's liabilities rather than benefiting employees, Measure B violates the PPA and the fiduciary duties provided therein.

**3. Adjusting Retiree Health Contribution Rates**

As discussed more thoroughly above, the City, through Section 1512-A(a) of Measure B, requires its employees to contribute a minimum of fifty percent costs the normal cost and unfunded liabilities of its retiree healthcare plan. However, pursuant to the PPA and the SJMC, the Board, and not the City, is authorized to adjust contribution rates. (*See* SJMC § 3.28.350, 3.28.385, 3.28.880.) Therefore, Section 1512-A(a) violates the PPA.

**4. Imposes City's Interests on Retirement Board's Fiduciary Duties**

Measure B requires the Board to administer the Federated System to "minimize any risk to the City and its residents…." (Section 1513-A(a).) This command is a violation of the PPA. The California Supreme Court has held that "even assuming article XVI, section 17 creates a duty to minimize employer contributions, it cannot be construed to require [a retirement board] to manage the retirement system in a way which would favor an employer over the beneficiaries to whom it owes a fiduciary duty." (*Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1493 ("*Sacramento PERS*").) This is precisely what Measure B does. Measure B was designed by the City on the basis of its alleged fiscal crisis, and it was sold to the voters as a means to "provide its citizens with Essential City Services" which have "been and continue[] to be threatened by budget cuts caused mainly by the climbing costs of employee benefit programs, exacerbated by the economic crisis." (Section 1501-A.) While Measure B says that it was designed to "provide reasonable … post employment benefits" to retirees (Section 1502-A), nothing within Measure B provides its employees or retirees with an advantage; as such, it directly contravenes the PPA by making it near impossible for the Federated Board to administer the retirement System in the best interests of its beneficiaries; the only party Measure B benefits is the City itself. *Sacramento PERS* forbids such an outcome. (*See* 229 Cal.App.3d at 1493.)

In addition, Section 1513-A of Measure B sets forth certain requirements on the Board with respect to its maintenance of the actuarial soundness of the plan. In doing so, Section 1513-A(a) requires the Board to "minimize any risk to the City and its residents" and to be "prudent and reasonable in light of the economic climate" when adopting retirement plans pursuant to Measure B. Not only do such requirements contravene the PPA's command that such plans be administered in the

interest of its beneficiaries, but it also usurps the Board's plenary power and exclusive fiduciary responsibility to provide for actuarial services and make investment decisions (as mandated by PPA).

Measure B further imposes on the Board's authority over actuarial matters, as granted it by the SJMC. (SJMC §§ 3.28.155, 3.28.160, 3.28.170, 3.28.200, 3.28.300, 3.28.350(B) ("The Board shall … maintain[] the actuarial soundness of the plan in a manner consistent with [the PPA].") Importantly, the SJMC gives the Board authority over setting actuarial assumptions related to the System:

> Upon the basis of any or all of such investigations, valuations and determinations, *the board shall adopt* such mortality, service and other tables, actuarially assumed annual rate of return, and *other actuarial assumptions* as it may deem reasonably necessary, and, subject to such limitations as are set forth elsewhere in this chapter, it shall fix and from time to time make such revisions or changes in the rates of contribution required of members and of the city as it may determine reasonably necessary to provide the benefits provided for by this retirement plan.

(SJMC 3.28.200 (emphasis added).) Through Measure B, the City impedes upon the Board's constitutional command--a command it recognized at one time through the SJMC.

## D. Right to Petition

### 1. Measure B Violates Constitutional Right to Petition By Imposing Penalty for Successfully Challenging Measure B

"The people have the right to … petition government for redress of grievances" (Cal. Const. art. I § 3). Section 1514-A of Measure B, the Measure's "Savings" clause, states:

> In the event [Section 1506-A(b)] is determined to be illegal, invalid or unenforceable as to Current Employees (using the definition in [Section 1506-A(a)]), then, to the maximum extent permitted by law, an equivalent amount of savings shall be obtained through pay reductions. Any pay reductions implemented pursuant to this section shall not exceed 4% of compensation each year, capped at a maximum of 16% of pay.

This clause imposes a cost or risk upon the exercise of the right to petition the courts for redress, and its purpose and effect is to chill the assertion of constitutional rights by penalizing those who choose to exercise them. The provision further deters members from challenging Measure B, by imposing an unreasonable, burdensome penalty for successfully invoking the Constitutional right to petition the courts.

"The right of access to the courts is indeed but one aspect of the right of petition" (*California Motor Trans. Co.* v. *Trucking Unlimited* (1972) 404 U.S. 508), but it is "among the most precious of the liberties safeguarded by the Bill of Rights." (*United Mine Workers* v. *Ill. Bar Assoc.* (1967) 389

U.S. 217, 222.) Further, this corollary right has "a sanctity and a sanction not permitting dubious intrusions." (*Thomas* v. *Collins* (1945) 323 U.S. 516, 530.)

In *California Teachers Assn. v. State of California* (1999) 20 Cal.4th 327 ("*CTA*"), the Supreme Court found that a statute imposing one-half the cost of an administrative hearing on unsuccessful teachers violated the right to petition by inhibiting free access to judicial review. (*See also Long Beach* v. *Bozek* (1982) 31 Cal.3d 587, 582-589 (holding right to petition completely precludes government entity from suing unsuccessful litigant).) As stated in *CTA*, "[t]he imposition of a cost or risk upon the exercise of the right to a hearing is impermissible if it has no other purpose or effect than to chill the assertion of constitutional rights by penalizing those who choose to exercise them." (*CTA*, 20 Cal.4th at 338 (emphasis added).) Broadly stated, any government action designed to of having the effect of keeping a citizen from initiating legal remedies infringes upon the right to petition. (*In re Workers Comp. Refund Cases* (8th Cir. 1995) 46 F.3d 813 (*citing Harrison v. Springdale Water* (8th Cir.1986) 780 F.2d 1422).) This principle is broadly construed and applied: the right of access to courts may not be directly or indirectly impaired. (*Harrison,* at 1428 (emphasis added).) Because an "indirect impairment" of the right to petition may include "retaliatory action taken against an individual designed either to punish him for having exercised his constitutional right to seek judicial relief or to intimidate or chill his exercise of that right in the future," courts routinely find laws that contain "litigation penalties" to be unconstitutional. (*CTA*, *supra*, 20 Cal.4th at 331, 338.)

In the instant case, Measure B imposes a significant penalty on citizens who successfully seek judicial review that is potentially greater than the reduction Measure B imposes. Section 1514-A provides that in the event an employee successfully challenges section 1506-A(b), current employees would be forced to make additional retirement contributions up to a maximum of 16% of their pensionable pay. There is no states justification for this, nor is it clear where the 16% amount is derived from (The City offered no evidence on this part, and none of its witnesses were found competent to testify as to the basis of Measure B's provisions).

On its face, therefore, Measure B unconstitutionally chills the right to seek judicial review by imposing a penalty for a successful challenge. According to the City, a sixteen percent reduction in pay is less desirable than an increase in retirement contributions because the former results in lower levels of pension benefits based upon lower pensionable pay. (*See* City's Pre-Trial Brief, p. 15:19-

22; 16:1-6; *see also* Tr. 741:7-28; 742:1-9.) In other words, the maximum penalty imposed by section 1514-A is greater than the maximum detrimental effect of section 1506-A(b). [8]

In addition to violating current employees' right to petition, Measure B also imposes an impermissible litigation penalty on the petitioner labor unions, because, if they are successful in challenging section 1506-A(b), section 1514-A imposes automatic wage reductions on current employees without first permitting statutorily-required bargaining over this mandatory subject of collective bargaining. (*See* Gov. Code sect. 3500 et seq. (hereinafter "Meyers-Milias-Brown Act" or "MMBA").) For this reason, the City is incorrect in its contention that, because it exercises plenary authority over employee compensation, Section 1514-A's act of automatically decreasing compensation cannot violate the law. Furthermore, if the City were right that it could impose the pay reductions without voter approval and without collective bargaining, then what reason was there for the City to include that section in Measure B other than to present a clear penalty designed to discourage legal challenges to section 1506-A(b)?

Defendants may argue, as a general matter, that section 1514-A is merely intended to serve as an alternative means to achieve the objectives of section 1506-A(b) if the latter is found to be unconstitutional or illegal, and, thus, the pay reduction threatened by section 1514-A is not properly termed a "litigation penalty." This argument fails on two primary grounds. First, as discussed above, the harm imposed by section 1514-A is more severe than the detrimental effect of section 1506-A(b). Second, while the "additional retirement contributions" required by section 1506-A(b) necessarily address the City's unfunded pension liabilities (and, indeed, are explicitly linked to the City's unfunded liabilities as they are limited to "no more than 50% of the costs to amortize any pension unfunded liabilities . . ."), there is no requirement in section 1514-A that any "savings" achieved by the pay reductions threatened by that section be used to address the City's unfunded liabilities. This further suggests that 1514-A is not intended as an alternative method of achieving the purported objectives of section 1506-A(b), rather, it is intended as a penalty to discourage challenges to section 1506-A(b). Clearly, the provision is intended to have the effect of dissuading challenges to Measure B's VEP provisions.

///

///

///

[8] Furthermore, the punishment imposed by Section 1514-A is *harsher* than that imposed by Section 1506-A: arguably, the prospect of realizing the maximum level of increased pension contributions permitted by Section 1506-A is tied to the plan's performance and its level of unfunded liabilities. However, the realization of maximum level of wage cuts permitted under Section 1514-A is subject only to the City's discretion.

**2. City's Additional Arguments in Opposition Are Without Merit**

In its pre-trial brief, the cites a series of cases that do not support its position and quotes them out of context in in arguing that Section 1514-A cannot violate the right to petition. Importantly, none of those cases involved a situation where challenged legislation imposed a penalty on the *prevailing* party, as does Measure B. As such, they are distinguishable from *CTA*, which considered and invalidated a statute imposing a penalty for prevailing in court, and therefore the City's authorities do not govern this case. (*Supra,* 20 Cal.4th at 341.)

However, even if the Court were to apply the "free speech" analysis advocated by the City to this case, Section 1514-A is still unconstitutional under that framework because it is neither narrowly drawn to achieve a theoretical interest nor supported by a substantial governing interest. The record is devoid of any justification for the 16% penalty imposed by Section 1514-A.

*Section 1514-A Violates the Right to Petition as an Unconstitutional Impairment on Speech*

First, Section 1514-A is subject to a strict scrutiny analysis under the "free speech" case-law because Section 1514-A is content/viewpoint-based regulation that does not simply pose an "incidental" restriction on speech. (*See Vargas v. City of Salinas* (2012) 200 Cal.App.4th 1331, 1346.) Rather, it directly targets lawsuits that are critical of Section 1506-A, and successfully oppose it. The City must prove that Section 1514-A is "narrowly tailored and the least restrictive means to serve a compelling government interest." (*Ibid.* (citations omitted)); as demonstrated below, this is a task it cannot fulfill. However, Section 1514-A is unconstitutional even under a lesser level of scrutiny.

Defendants cite *Vargas* for the proposition that Section 1514-A is constitutionally sound under the intermediate scrutiny standard because it is "content neutral" and narrowly drawn to achieve a substantial governing interest. (City's Pre-Trial Brief, p. 20.) The plaintiffs in *Vargas* "were supporters of a ballot measure that would have repealed [the c]ity's utility tax," and, "[p]rior to the election, [the c]ity issued a report and published several articles describing the impact upon municipal services if the measure were enacted." ((2012) 200 Cal.App.4th 1331, 1339.) The plaintiffs sued the city for these aforementioned publications, and the city prevailed on its anti-SLAPP motion to strike the complaint and sought attorneys' fees for defending the action. The court rejected plaintiffs' contention that awarding the government agency attorneys' fees chilled its right to petition the courts because, it reasoned, "the government has an interest in speaking out on issues of public concern and in being free of the costs of defending meritless lawsuits aimed at infringing the government's free-speech activities." (*Id.* at 1350.) As the court explained, the anti-SLAPP statute

authorized recovery of attorneys' fees *only if* the plaintiff failed to demonstrate that the complaint was "legally sufficient and supported by a sufficient prima facie showing of facts to sustain a favorable judgment if the evidence submitted by the plaintiff is credited." (*Id.* at 1348 (citation omitted) (emphasis added).)

Unlike in *Vargas* where the anti-SLAPP fee shifting provision in question was designed to deter baseless, unmeritorious claims against the government or *Zuckerman v. State Bd. of Chiropractic Examiners* (2002) 29 Cal.4th 32, which authorized cost-shifting when a chiropractor was found guilty of misconduct, Section 1514-A punishes those who *successfully* challenge Section 1506-A, that is those that enforce important constitutional rights. As a result, Measure B discourages meritorious legal challenges and therefore chills legitimate "speech" in the form of access to the courts and petitions to redress grievances. Such a result is contrary to policy which favors the vindication of public rights. (*See e.g., Serrano v. Unruh* (1982) 32 Cal.3d 621; *Woodland Hills Residents Assn., Inc. v. City Council* (1979) 23 Cal.3d 917; *Arizona Right to Life Political Action Committee v. Bayless* (9th Cir. 2003) 320 F.3d 1002, 1007 ("Public policy should encourage a person aggrieved by laws he considers unconstitutional to seek a declaratory judgment…").)

Even assuming, *arguendo*, Section 1514-A was narrowly drawn, it is not supported by a substantial governing interest. In this case, the City attempts to confuse the record by claiming that it has a "legitimate" interest in freeing City resources. However, the focus of the inquiry is whether a legally tenable interest justify Section 1514-A, rather than Measure B as a whole.[9] There is no such interest present here, and an improper intent may be inferred, as it was in *CTA, supra*.

Even if the Court accepted the City's stated "substantial interest" justifying Section 1514-A, under *Zuckerman, supra,* requiring employees to take a sixteen percent wage reduction in the event of a successful challenge to Section 1506-A still violates the right to petition. (*See supra,* 29 Cal.4th at 40 ("Finally, we held in *CTA* that even if we could ignore the state's improper goal of discouraging unsuccessful hearings and instead focus on its interest in conserving public resources, to require unsuccessful teachers to pay half the cost of the adjudicator would still violate due process.").)

*a. Section 1514-A Violates Principles of Due Process*

Defendants cite *Zuckerman* for the proposition that the City had a legitimate interest in "free[ing] City resources to pay for essential City services." (*Supra,* 29 Cal.4th at 32.) However,

[9] Even the cases the City cites in arguing that its purported interest is one recognized as legitimate by courts focused on the justification for enacting the particular provision being challenged, not a larger statute of which the challenged provision was a part. (*See Zucerkman v. State* (2002) 29 Cal.4th 32; *Simpson v. Municipal Court* (1971) 14 Cal.App.3d 591.)

*Zuckerman* was not a case in which the challenged regulation bestowed upon the *prevailing* party an *automatic* penalty, as does Measure B. Indeed, the regulation in that case was upheld because it granted discretion to consider an appropriate penalty for unsuccessful challenges and allowed for judicial review of the charge. Therefore, as shown below, this case is unlike *Zuckerman*.

*Zuckerman*, which involved a Due Process challenge rather than one based on the Constitutional right to petition, considered a regulation by which the State Board of Chiropractic Examiners ("Board") could "request the administrative law judge to direct [a chiropractor found to have violated the [Chiropractic Initiative] Act] to pay a sum not to exceed the reasonable costs of the investigation and enforcement of the case." (*Id.* at 36, 38 (quoting Reg. 317.5, subd. (a).) The regulation, which was deemed constitutionally sound, gave the Board discretion to "reduce or eliminate the cost award" and permitted judicial review of the award. (*Id.* at 38 (quoting Reg. 317.5, subd. (c), 45.)

The court distinguished *CTA, supra,* from the case before on it several grounds. First of all, the law in *CTA*

> "required the disciplined teacher to pay *hearing* costs, in particular the cost of the adjudicator. But, under regulation 317.5, those costs are paid entirely by the Board, and a disciplined chiropractor must only pay certain *prehearing* costs. Although laws requiring a disciplined professional to pay for an adjudicator are 'virtually unprecedented', an examination of laws in California and other states reveals that laws imposing prehearing costs are not unusual."

(*Zuckerman, supra,* 29 Cal.4th at 40 (emphasis in original).) The court concluded that Regulation 317.5 "does not discourage chiropractors from seeking a hearing insofar as it requires them to pay investigation and prosecution costs the Board incurs *before* it files formal charges, for a chiropractor who admits the charges and does not request a hearing also must pay those costs." (*Id*. at 44 (emphasis in original).)

The court also observed that "regulation 317.5's further requirement that disciplined chiropractors must pay costs the Board incurs *after* charges are filed poses a greater risk of causing erroneous deprivations of the right to practice." (*Zuckerman, supra,* 29 Cal.4th at 44 (emphasis in original).) However, the court found that, unlike the statute in *CTA*, regulation 317.5 was constitutionally sound because it was "merely *discretionary*: the administrative law judge must determine whether the Board's costs are 'reasonable,' and the Board may 'reduce or eliminate' the administrative law judge's cost award." (*Id.* at 44 ("In *CTA*, we noted the critical importance of granting disciplinary bodies the discretion not to impose costs.") (emphasis in original).) The court

further "shared the[] concerns" expressed by federal court decisions that "serious constitutional problems would arise if a cost recoupment law was made mandatory in every case." (*Id.* at 47.)

This case implicates that very concern, since Section 1514-A(a) prescribes a *mandatory* penalty without leaving any sort of discretion to withhold punishment:

> "In the event Section 6 (b) is determined to be illegal, invalid or unenforceable as to Current Employees …, then, to the maximum extent permitted by law, *an equivalent amount of savings* ***shall*** *be obtained* through pay reductions…."

(Emphasis added.) In the event of a successful challenge to Section 1506-A, Measure B requires the City to affect such pay reductions. Therefore, sections 1514-A also violated due process.

*b. Right to Petition Challenges Are Not Restricted to Legislation Concerning Matters of Public Concern*

The City has incorrectly stated that legal challenges based on the right to petition must be directed at laws implicating a matter of public concern. (City's Pre-Trial Brief, p. 20:1-3.) However, *Vargas*--the case the City cites for its statement--does not stand for this proposition, and our Supreme Court has not imposed such a requirement. (*See, e.g., CTA, supra,* 20 Cal.4th at 347 ("The facial validity of the procedures for terminating public employees depends upon a balancing of the competing interests at stake. These include the *private* interest affected by the official action, the government's interest, and the risk of an erroneous deprivation of the *private* interest, including the probable value, if any, of additional or substitute procedural safeguards and the burdens such safeguards would entail." (Emphasis added.)

However, even if there was a "public concern" requirement in right to petition cases, it is present here. First, this case involves the City's allocation of city funds and its claims that such funds were insufficient to pay earned retirement benefits and that, because of its retirement obligations, it lacked resources to finance "essential city services." However, lawsuits challenging a government's use of public funds, including its use towards employee compensation, presents matters of public concern. (*See Pickering v. Bd. of Educ.* (1968) 391 U.S. 563, 571-72; *McKinley v. City of Eloy* (9th Cir. 1983) 705 F.2d 1110, 1114-1115.) Next, the public has an interest in preventing arbitrary and unconstitutional economic harm to those very civil servants that deliver services. Furthermore, the right to access the courts inherently is a matter of public concern as it is a constitutionally-based rights. (*See People v. Dixon* (2007) 148 Cal.App.4th 414, 438 ("[T]he public undoubtedly has an interest in having access to the courts and ensuring the integrity of the fact finding process.").)

The City's citation to *White v. Nevada* (9th Cir. 2009) 312 Fed.Appx. 896, in support of the proposition that plaintiffs' challenges are a matter of private concern is unavailing. (City's Pretrial

Brief at 20:1-3, fn.20.) *White* did not involve the constitutional right to petition; rather, it addressed a claim for First Amendment retaliation brought pursuant to 28 U.S.C. sect. 1983 for certain whistle-blowing activities. (*Id.* at 897.) The *White* plaintiffs did not complain of a legislation burdening the right to engage in the protected activity in the first place, as is the case here; rather, they complained of actions taken against them *after* they exercised their First Amendment rights. (*Id.* at 896-87.) While the *White* plaintiffs' complaints involved their own individual compensation issues rather than matters of public concern, AFSCME's cause of action directed towards Section 1514-A *does not*.

Finally, The City's argument that the fact that multiple plaintiffs filed lawsuits in this case is means that "plaintiffs cannot prove that Measure B deterred them from filing suit over increase contribution rates." (City's Pre-Trial Brief, p. 20 fn.16) is circular. If such an argument were meritorious, then not a single cause of action alleging a violation of the constitutional right to petition could succeed. This is simply not what the people intended when they authorized challenges to legislation on such grounds. (*See, e.g., Turner v. Burnside* (11th Cir. 2008) 541 F.3d 1077, 1086 ("[T]he fact the inmate has filed the lawsuit does not necessarily mean that the alleged threat did not deter him, or would not have deterred a reasonable inmate of ordinary firmness and fortitude, from pursuing the administrative remedy.").)

**F. Promissory and Equitable Estoppel**

The City should be estopped from enforcing Measure B and denying its employees and retirees the benefits it promised them throughout their careers. Below, we demonstrate that the City intended to induce reliance on its promised retirement benefits in order to stay a competitive with the state and other municipal employers. Evidence of its intent to induce reliance is in the fact that it posted its communications regarding benefits on its public website. Furthermore, we show that members suffered major detriment by working for the City and foregoing the opportunity to earn Social Security benefits by working in the private sector. Finally, we demonstrate how specific AFSCME members relied upon the City's intentional misrepresentations to their detriment.

AFSCME incorporates by reference the discussion of law pertinent to its estoppel causes of action from pages 53-58 of its Pre-Trial Brief as though fully set forth herein.

**1. City Intended to Induce Reliance and Failure to Earn S.S. Benefits Resulted in Detriment**

The evidence demonstrates that the City intended to induce reliance on its promise of its pre-Measure B retirement package for the purposes of attracting talent to its workforce. The City conceded that as other California jurisdictions offered increased employee and retirement benefits, San José maintained comparable benefits. (Tr. 521:4-13, 23-27; 522:2-6.) The reasonable inference

is that San José did so in order to stay competitive with the state and other local governments in order to recruit and retain qualified employees.

Furthermore, the City maintained a retirement services website in order to provide to retirement plan members "public information about the plans" and "private, secured data about each member/retiree." (Exh. 370.) Retirement services announced its new website to members and retirees with a letter that did not include any caution not to rely on the posted information. Subsequently, the City posted various documents and articles on its website informing members of their rights to retirement benefits. It is clear that the City intended to induce reliance upon the information it posted on its websites.

It is apparent that AFSCME members incurred major detriment by accepting City service with the promise of a certain level of retirement benefits and foregoing the opportunity to contribute towards and receive Social Security benefits upon retiring. For example, the City reminded its members through its retirement handbooks that they would "not receive Social Security credit for their City service." (*See, e.g.,* Exh. 329, p. 10 (AFSCME003894); *see also* Exhs. 365, 366 (Statement Concerning Your Employment in a Job Not Covered by Social Security).) These same handbooks reiterated the benefits City employees would expect to receive for working with the City and foregoing the opportunity to contribute to Social Security.

So serious is the missed opportunity to collect Social Security benefits upon retirement that the federal government requires public employers not participating in the program to inform employees of the fact that their positions are not covered by Social Security; employees are required to provide a signature acknowledging their understanding of the fact. (42 U.S.C., § 1320b-13(d).) The City currently sends its employees such a disclosure and requires their signed acknowledgement. (*See, e.g.,* Exhs. 366-67.)

Therefore, it is clear that members were aware that they were foregoing the opportunity to earn Social Security benefits and were dependent on the benefits afforded by the Federated plan. Because they suffered such detriment by relying on the City's representations of promised benefits, the City should be estopped from enforcing Measure B.

**2. <u>Individual Members Detrimentally Relied on the City's Misrepresentations</u>**

Individual AFSCME members also testified that they relied on the City's promised retirement package in not working in the public sector and foregoing a Social Security benefit or by staying in the employ of the City as long as they did. For example, as previously discussed, Martinez testified

that she was promised free healthcare after retiring as long as she completed fifteen years of service and stayed in the Kaiser co-pay plan. (*See* Tr. 329:22-26; 334: 17-19.)

Furthermore, active employee Jeffrey Rhoads testified that Ms. Gan, a manager for the City, made certain representations about retirement benefits offered by the City and that these representations were repeated during his new employee orientation. In particular, he was told that if he worked for thirty years, he would earn 75% of his final salary based upon the 2.5% accumulation formula and guaranteed retiree health benefits after fifteen years of service. (Tr. 103:25-28; 104:1-10, 22-28; 105:1-11.) He relied on these representations in taking a full-time position with the City. In doing so, he opted not to apply for a private sector position because he looked forward to the City's retirement benefits even though the other position paid more and his ex-wife continued to encourage him to apply. (Tr. 106:1-21.) He also passed on an opportunity to apply for a position with ATT that the company's Assistant Director recommended that he apply. At that point, he was close to fifteen years of service and did not want to lose his opportunity to earn retiree health benefits. (*See, e.g.,* Tr. 106:24-28; 107:1-6, 15-27.)

By accepting employment with and continuing to work for the City, Rhoads passed up on these opportunities. Furthermore, he forewent the opportunity to earn Social Security benefits upon retirement. (See Tr. 105:19-28.) As a result of staying with the City, he may not be able to retire after thirty years of service and earn 75% of his final compensation--as was represented to him at the onset of his employment--and he will not receive the retiree health benefits he was promised. (Tr. 108:26-27; 109:8-13.)

**F. <u>Severability</u>**

The question of application of severability is a matter of appropriate remedy and is within the inherent power of the Court. For the reasons set forth in the POA's Post-Trial Brief, AFSCME contends the Court must determine whether the challenged provisions of Measure B are severable or whether the entire Measure is nullified. For the reasons and authorities set forth in the POA's and other Petitioner's Post-trial briefs, which are incorporated by reference herein, Measure B should be struck down in its entirety.

///

///

///

///

## V. CONCLUSION

For all these reasons and those set forth in the other Plaintiffs' post-trial briefs--to the extent that they are pertinent to AFSCME and do not contradict any positions taken herein--the Court should enter judgment in favor of AFSCME on its claims and deny the declaratory relief requested by the City or, alternatively, enter judgment for AFSCME on all the City's federal cross-claims.

Dated: September 10, 2013

BEESON, TAYER & BODINE, APC

By: _____
TEAGUE P. PATERSON
VISHTASP M. SOROUSHIAN
Attorneys for AFSCME LOCAL 101

## CHART A

**Federated System Contribution Rates, Funded ratio, and UAL as % of payroll**

| Year of report | City total Cost (% payroll) | Employee (% salary) | Funded Ratio -- actuarial value | UAL as % of payroll | Exhibit Number |
|---|---|---|---|---|---|
| 1982 | 19.89 | 8.17 | | | 412 (p.17) |
| 1984 | 15.84 | 7.20 | | | 411, 412 |
| 1985 | 15.72 | 7.52 | | | 398 |
| 1989 | 14.22 | 6.39 | | | 399, 410 |
| 1990 | 13.92 | 6.37 | | | 400 |
| 1993 | 15.59 | 6.88 | 84% | 64% | 401; 402; 424 |
| 1994 | | | 85% | 62% | 424 |
| 1995 | 18.11 | 14.6 | 86% | 60% | 402;424 |
| 1996 | | | 89% | 45% | 424 |
| 1997 | 15.37 | 4.36 | 94.1% | 32% | 403, 404, 405; 424 |
| 1998 | | | 92.3% | 31% | 434 |
| 1999 | 15.33 | 4.17 | 94.1% | 24% | 403, 404, 405, 433 |
| 2000 | | | 93.3% | 27% | 434, 433 |
| 2001 | 13.82 | 4.04 | 98.9% | 5% | 405, 406,429, 433 |
| 2002 | 15.20 | 5.08 | 98.9% | 5% | 362, 433 |
| 2003 | 15.20 | 4.26 | 98.9% | 4% | 406, 407; 426, 429, 433 |
| 2004 | 17.12 | 6.06 | 97.6% | 11% | 429, 363 |
| 2005 | 14.96 | 4.26 | 97.6% | 11% | 407, 426, 429 |
| 2006 | | | 80.9% | 114% | 429, 433, 434 |
| 2007 | 18.16 | 4.26 | 80.9% | 114% | 406,* 426; 429 |
| 2008 | 18.16 | 4.28 | 82.8% | 116% | 429 |
| 2009 | 18.31 | 4.28 | 82.8% | 116% | 408, 409, 426 |
| 2010** | 18.31 | 4.28 | 70.70% | 236% | 418, 426 |
| 2011** | 13.28 | 4.88 | 68.9% | 283% | 416, 417, 418, 426 |
| 2012 | 12.76 | 4.68 | 62% | | 416, 417 |

*Drop in funded status reflects actuarial assumption changes adopted by Board, namely recution indiscount rate from 8.25% to 7.75%.

** Elimination of 1,600 FTE from City payroll, and beginning of recognition asset value losses occasioned by liquidity crisis in Fall of 2008 and ensuing great recession

## PROOF OF SERVICE

## STATE OF CALIFORNIA, COUNTY OF ALAMEDA

I declare that I am employed in the County of Alameda, State of California. I am over the age of eighteen (18) years and not a party to the within cause. My business address is Beeson, Tayer & Bodine, Ross House, Suite 200, 483 Ninth Street, Oakland, California, 94607-4051. On this day, I served the foregoing Document(s):

**PLAINTIFF/PETITIONER AFSCME LOCAL 101'S POST-TRIAL BRIEF**

☐ **By Mail** to the parties in said action, as addressed below, in accordance with Code of Civil Procedure §1013(a), by placing a true copy thereof enclosed in a sealed envelope in a designated area for outgoing mail, addressed as set forth below. I am readily familiar with this business's practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service in a sealed envelope with postage fully prepaid.

☐ **By Personally Delivering** a true copy thereof, to the parties in said action, as addressed below in accordance with Code of Civil Procedure §1011.

☐ **By Messenger Service** to the parties in said action, as addressed below, in accordance with Code of Civil Procedure § 1011, by placing a true and correct copy thereof in an envelope or package addressed to the persons at the addresses listed below and providing them to a professional messenger service.

☐ **By UPS Overnight Delivery** to the parties in said action, as addressed below, in accordance with Code of Civil Procedure §1013(c), by placing a true and correct copy thereof enclosed in a sealed envelope, with delivery fees prepaid or provided for, in a designated outgoing overnight mail. Mail placed in that designated area is picked up that same day, in the ordinary course of business for delivery the following day via United Parcel Service Overnight Delivery.

☐ **By Facsimile Transmission** to the parties in said action, as addressed below, in accordance with Code of Civil Procedure §1013(e).

☒ **By Electronic Service.** Based on a court order or an agreement of the parties to accept service by electronic transmission, I caused the documents to be sent to the persons at the electronic notification addresses listed below. I did not receive, within a reasonable time after the transmission, any electronic message or other indication that the transmission was unsuccessful.

**SEE ATTACHED SERVICE LIST**

I declare under penalty of perjury that the foregoing is true and correct. Executed in Oakland, California, on this date, September 10, 2013.

Marlene Dunleavy

Marlene T. Dunleavy

**SERVICE LIST**

| | |
|---|---|
| Greg McLean Adam, Esq.<br>Jonathan Yank, Esq.<br>Gonzalo C. Martinez, Esq.<br>Amber L. West, Esq.<br>CARROLL, BURDICK & McDONOUGH LLP<br>44 Montgomery Street, Suite 400<br>San Francisco, CA 94104<br><br>*Attorneys for Plaintiff, SAN JOSE POLICE OFFICERS' ASSOCIATION (Santa Clara Superior Court Case No. 112CV225926)* | Arthur A. Hartinger, Esq.<br>Geoffrey Spellberg, Esq.<br>Linda M. Ross, Esq.<br>Jennifer L. Nock, Esq.<br>Michael C. Hughes, Esq.<br>MEYERS, NAVE, RIBACK, SILVER & WILSON<br>555 12th Street, Suite 1500<br>Oakland, CA 94607<br><br>*Attorneys for Defendants, THE CITY OF SAN JOSE AND DEBRA FIGONE* |
| John McBride, Esq.<br>Christopher E. Platten, Esq.<br>Mark S. Renner, Esq.<br>WYLIE, McBRIDE, PLATTEN & RENNER<br>2125 Canoas Garden Avenue, Suite 120<br>San Jose, CA 95125<br><br>*Attorneys for Plaintiffs/Petitioners, ROBERT SAPIEN, MARY McCARTHY, THANH HO, RANDY SEKANY AND KEN HEREDIA (Santa Clara Superior Court Case No. 112-CV-225928)*<br><br>*AND*<br><br>*Plaintiffs/Petitioners, JOHN MUKHAR, DALE DAPP, JAMES ATKINS, WILLIAM BUFFINGTON AND KIRK PENNINGTON (Santa Clara Superior Court Case No. 112-CV-226574)*<br><br>*AND*<br><br>*Plaintiffs/Petitioners, TERESA HARRIS, JON REGER, MOSES SERRANO (Santa Clara Superior Court Case No. 112-CV-226570)* | Harvey L. Leiderman, Esq.<br>REED SMITH, LLP<br>101 Second Street, Suite 1800<br>San Francisco, CA 94105<br><br>*Attorneys for Defendant, CITY OF SAN JOSE, BOARD OF ADMINISTRATION FOR POLICE AND FIRE DEPARTMENT RETIREMENT PLAN OF CITY OF SAN JOSE (Santa Clara Superior Court Case No. 112CV225926)*<br><br>*AND*<br><br>*Necessary Party in Interest, THE BOARD OF ADMINISTRATION FOR THE 1961 SAN JOSE POLICE AND FIRE DEPARTMENT RETIREMENT PLAN (Santa Clara Superior Court Case No. 112CV225928)*<br><br>*AND*<br><br>*Necessary Party in Interest, THE BOARD OF ADMINISTRATION FOR THE 1975 FEDERATED CITY EMPLOYEES' RETIREMENT PLAN (Santa Clara Superior Court Case Nos. 112CV226570 and 112CV22574)*<br><br>*AND*<br><br>*Necessary Party in Interest, THE BOARD OF ADMINISTRATION FOR THE FEDERATED CITY EMPLOYEES RETIREMENT PLAN (Santa Clara Superior Court Case No. 112CV227864)* |

| | |
|---|---|
| Stephen H. Silver, Esq.<br>Richard A. Levine, Esq.<br>Jacob A. Kalinski, Esq.<br>SILVER, HADDEN, SILVER, WEXLER & LEVINE<br>1428 Second Street, Suite 200<br>Santa Monica, CA 90401-2367<br><br>*Attorneys for Plaintiffs, SAN JOSE RETIRED EMPLOYEES ASSOCIATION, HOWARD E. FLEMING, DONALD S. MACRAE, FRANCES J. OLSON, GARY J. RICHERT and ROSALINDA NAVARRO (Santa Clara Superior Court Case No. 112CV233660)* | |